PRINCIPLES OF ECONOMICS

BY

F. W. TAUSSIG

HENRY LEE PROFESSOR OF ECONOMICS
IN HARVARD UNIVERSITY

VOLUME II

SECOND EDITION REVISED

New York
THE MACMILLAN COMPANY
1915

Set up and electrotyped Published October, 1911 Reprinted December, 1911, April, August, October, 1912, February, September, December, 1913
Second edition revised March, 1915. Reprinted October, December, 1915.

Norwood Press
J. S. Cushing Co. — Berwick & Smith Co.
Norwood, Mass., U.S.A.

THE MACMILLAN COMPANY
NEW YORK · BOSTON · CHICAGO
SAN FRANCISCO

MACMILLAN & CO., LIMITED
LONDON · BOMBAY · CALCUTTA
MELBOURNE

THE MACMILLAN CO. OF CANADA, LTD.
TORONTO

CONTENTS

BOOK V

THE DISTRIBUTION OF WEALTH

CHAPTER 38

VOL. II PAGES

INTEREST ON CAPITAL USED IN PRODUCTION. THE CONDITIONS OF DEMAND 3–15

Section 1. What is meant by distribution, 3 — Sec. 2. The essential problem as to interest. Money is not the cause of interest, nor does its quantity affect the rate of interest, 4 — Sec. 3. Why there is a demand for present means; the effectiveness of the time-using processes of production. Is capital productive? 5 — Sec. 4. How the marginal effectiveness or productivity of capital determines the rate of return. A consumer's surplus arises from the more effective applications. Analogy to the problems of value and utility, 8 — Sec. 5. Is there a general tendency to diminishing returns from successive doses of capital? 11.

CHAPTER 39

INTEREST (*continued*). THE EQUILIBRIUM OF DEMAND AND SUPPLY 16–28

Section 1. Accumulation of present means needs an inducement, 16 — Sec. 2. The gradations in the disposition to save. Cases where the inducement needs to be slight, 16 — Sec. 3. Cases where a return is sought. Possibility that a lowered return will sometimes induce larger savings. More often, lowered return checks saving. The conception of marginal savers, 19 — Sec. 4. Diagrams expressing the equilibrium of supply and demand. Savers' surplus, 22 — Sec. 5. The steadiness of the rate of interest in modern times and its significance, 26 — Sec. 6. The race between accumulation and improvement, 27.

CHAPTER 40

INTEREST, FURTHER CONSIDERED 29–43

Section 1. Loans for consumption introduce no new principle as to demand, but are much affected by the absence of full competition, 29 — Sec. 2. Public borrowing for wars an important form of such loans in modern times, 32 — Sec. 3. Durable consumer's goods, as a form of investment, again introduce no new principle, 32 — Sec. 4. No grounds for distinguishing between producer's capital and consumer's capital, so far as interest is concerned. Exchange of present for future the most general statement of the cause of inter-

VOL. II PAGES

est, 35 — Sec. 5. The mechanism of banking and credit makes interest all-pervasive, 37 — Sec. 6. Variations in the rate of interest in different countries and for different investments, 38 — Sec. 7. The justification and social significance of interest, 41.

CHAPTER 41

OVERPRODUCTION AND OVERINVESTMENT 44–54

Section 1. Overproduction, in the sense of excess beyond the possibility of use, is impossible. The extensibility of wants, 44 — Sec. 2. Overproduction, in the sense of production beyond the stage of profit, is possible if investment proceeds unendingly. The process of advances to laborers and the readjustment of production under the supposed conditions. Check to the extreme result, from the cessation of accumulation. The reasoning of Rodbertus criticized, 45 — Sec. 3. A real tendency to overproduction, through overinvestment in the familiar industries, 50 — Sec. 4. Industries with large plant, best managed under continuity of operation, are tempted to overproduction or else to combination, 52 — Sec. 5. The phenomena of crises and industrial depression are in reality different from those of overproduction, 53.

CHAPTER 42

RENT, AGRICULTURE, LAND TENURE 55–75

Section 1. The theory of surplus produce or "rent." Rent does not enter into the price-determining expenses of production. Rent is not the specific product of land, 55 — Sec. 2. The existence of rent is dependent upon diminishing returns from land. Advantages of situation as affecting rent, 58 — Sec. 3. Qualifications of the principle of diminishing returns: a possible stage of increasing returns; specific plots alone to be considered; a given stage of agricultural skill assumed, 61 — Sec. 4. The stage when the tendency to diminishing returns is sharp, 64 — Sec. 5. Are there original and indestructible powers of the soil? Predatory cultivation; intensive and extensive agriculture. Inherent differences tend to be lessened, but do not disappear, 65 — Sec. 6. Land tenure. Cultivation by owners, each with moderate holdings, of greatest social advantage, 70 — Sec. 7. Should the community appropriate or retain for itself agricultural rent? 72.

CHAPTER 43

URBAN SITE RENT . . . .

Section 1. How rent arises on sites for retail trading, w trading, manufactures, dwellings, 76 — Sec. 2. The pr

VOL. II PAGES

diminishing returns on urban sites; its operation less steep than for agricultural land, 80 — Sec. 3. Site rent depends upon shrewdness in utilization. The activity of real estate speculators, 83 — Sec. 4. When capital is sunk irrevocably in the soil, there is difficulty in separating rent from return on capital. How far ground rent is identical with economic rent, 84 — Sec. 5. How far the activity of real estate dealers and speculators is productive, 87 — Sec. 6. Urban rent is sometimes deliberately created; is it then economic rent? 89.

CHAPTER 44

RENT (*concluded*) 92–106

Section 1. The rent of mines, how influenced by risk. Diminishing returns on mines, 92 — Sec. 2. Are mining royalties rent? 96 — Sec. 3. The selling price of a site is a capitalization of its rent, 97 — Sec. 4. The problem of appropriating rent for the public is presented most sharply by urban sites. The possibility of leases on long term by the state; the historical development of unqualified private ownership and of vested rights, 98 — Sec. 5. The future increase of rent a proper object of taxation. Modes of levying such taxes, 102.

CHAPTER 45

MONOPOLY GAINS 107–114

Section 1. Absolute monopolies; industrial monopolies. Patents and copyrights as instances of absolute monopolies; the grounds for creating them by law, 107 — Sec. 2. "Public service" monopolies. Increasing returns and increasing profits, 110 — Sec. 3. Combinations and "Trusts"; the uncertainty as to the extent of their monopoly power, 112 — Sec. 4. The capitalization of monopoly gains and the problems as to vested rights, 113.

CHAPTER 46

THE NATURE AND DEFINITION OF CAPITAL 115–123

Section 1. Is the distinction between interest and rent tenable, in view of the wide extent of differential gains of a monopoly sort? Grounds for maintaining that all returns from property of any kind are homogeneous, 115 — Sec. 2. A different conception of "rent" and "interest," the two being regarded as different ways of stating the same sort of income. "Artificial" and "natural" capital. How measure the amount of capital? 117 — Sec. 3. The important questions are on the effectiveness of competition, the existence of a normal rate of interest, the justification of interest, 120.

CHAPTER 47

VOL. II PAGES

DIFFERENCES OF WAGES. SOCIAL STRATIFICATION 124–146

Section 1. Differences of wages which serve to equalize attractiveness of different occupations; domestic servants, university teachers, public employees, 124 — Sec. 2. Irregularity of employment and risk in their effect on relative wages. Expense of training, 126 — Sec. 3. Obstacles to free movement bring about real differences. Full monopoly rare, 127 — Sec. 4. Expense of education as an obstacle to mobility, 129 — Sec. 5. Inequalities of inborn gifts and social stratification. Uncertainty of our knowledge concerning the influence of inborn gifts, 130 — Sec. 6. Noncompeting groups, roughly analyzed as five. The broad division between soft-handed and hard-handed occupations, 134 — Sec. 7. Tendency to greater mobility in modern times. The position of common laborers, 138 — Sec. 8. What differences in wages would persist if all choice were free, 141 — Sec. 9. Why the wages of women are low, and wherein the labor of women is socially advantageous, 142.

CHAPTER 48

WAGES AND VALUE 147–157

Section 1. "Expenses of production" and "cost of production" again considered. If there were perfect freedom of choice among laborers, value would be governed by cost, 147 — Sec. 2. There being noncompeting groups, demand (marginal utility) governs relative wages. How this principle applies to a grade or group; marginal indispensability, 148 — Sec. 3. Qualifications: earnings may be so divergent as to cause seepage from one group into another; the standard of living may affect numbers within a group, 152 — Sec. 4. The lines of social stratification are stable; hence changes from the existing adjustments of value are not usually affected by them, 153 — Sec. 5. The theory of international trade brought into harmony with the theory of value under noncompeting groups, 154 — Sec. 6. Analogies between international trade and domestic trade, 156.

CHAPTER 49

BUSINESS PROFITS 158–171

Section 1. Business profits rest on the assumption of risks, 158 — Sec. 2. Position of the business man as receiver of a residual income. Irregularity and wide range of this income, its relation to prices. Though irregular, it is not due to chance, 159 — Sec. 3. The part played by inborn ability; that played by opportunity, environment, training, 161 — Sec. 4. The qualities requisite for success: imagination, judgment, courage. Mechanical talent not so impor-

VOL. II
PAGES

tant as might be expected. Relations of the business man to inventors. Diversity of qualities among the successful, 163 — Sec. 5. A process of natural selection among business men. Natural capacity tells more than in most occupations, 166 — Sec. 6. Motives of business activity and money-making. Social ambition the main impulse; other motives are also at work, 167 — Sec. 7. What changes would occur if business ability were very plentiful and capacity for muscular labor very scarce, 170.

CHAPTER 50

BUSINESS PROFITS (*continued*) 172–191

Section 1. Analogy between business profits and rent. A similar analogy in other occupations. How far the element of risk vitiates the analogy, 172 — Sec. 2. The difference in business abilities explains differences in cost of production. The conception of the "representative firm" as settling normal expenses of production, 175 — Sec. 3. One of the manifestations of business ability is in the selection of good natural resources. In the end, an important difference between economic rent and differential business profits, 177 — Sec. 4. The connection between the return on capital and business profits. Relations between owners and managers of capital at different times. Modern tendency toward a separation of functions and rewards, 179 — Sec. 5. For considerable periods, command of capital brings in a given enterprise the probability of larger profits; but not in the long run without business ability, 181 — Sec. 6. For industry as a whole and capital as a whole, there is a connection for considerable periods between interest and business profits. How they may diverge in the end, 183 — Sec. 7. A view of business profits which distinguishes them sharply from wages, as arising solely in a dynamic state, 184 — Sec. 8. Another view, which lays emphasis on risk, and distinguishes between the wages of salaried managers and the "profits" of independent business men. The salaried manager often rewarded *de facto* in proportion to "profits," 185 — Sec. 9. Legitimate and illegitimate business profits. Their restriction within the legitimate limits dependent on the removal of monopoly gains and the maintenance of a high plane of competition, 187.

CHAPTER 51

GENERAL WAGES 192–208

Section 1. The fundamental question as to general wages is raised by the case of hired laborers, 192 — Sec. 2. The notion that lavish expenditure creates demand for labor and makes wages high. Consequences of investment as compared with "expenditure," 192 — Sec. 3. The fallacy of "making work." Why hired laborers uni-

VOL. II PAGES

versally desire that employment should be created and dislike labor-saving appliances, 194 — Sec. 4. The theory of the specific product of labor as determining wages, 197 — Sec. 5. Wages depend on the discounted marginal product of labor. Explanation of "margin" and of "discount." Advances to laborers, 198 — Sec. 6. Some qualifications. (1) The current rate of interest is assumed to be settled by time preference, otherwise there is reasoning in a circle. (2) A broad competitive margin is assumed, otherwise there is no settlement either of interest or of wages, 200 — Sec. 7. The mechanism of advances to laborers, the flow of real income into their hands, the reservoir of existing supplies, the replacement of what is advanced, 203 — Sec. 8 With the increasing complexity of production, interest tends to be a larger part, wages a smaller part, of the total income of society, 205 — Sec. 9. The theory of general wages, though it seems remote from the problems of real life, is of high importance for the great social questions, 207.

CHAPTER 52

POPULATION 209–225

Section 1. The Malthusian theory, how far strengthened by biological science, 209 — Sec. 2. The maximum birth rate, the minimum death rate, the consequent possibilities of multiplication. In what sense there is a tendency to rapid multiplication; the positive and preventive checks, 210 — Sec. 3 The actual birth rates and death rates of some countries in modern times. A high birth rate ordinarily entails a high death rate. Explanation of exceptions. The situation in the United States, 214 — Sec 4. Does a high birth rate cause low wages, or *vice versa?* Interaction of causes. A limitation of numbers not a cause, but a condition, of general prosperity and high wages, 220 — Sec. 5. The standard of living affects wages, not directly, but through its influence on numbers. Fallacies on this subject, 221 — Sec. 6. Mode in which the modern decline in the birth rate has taken place, 223.

CHAPTER 53

POPULATION (*continued*) 226–237

Section 1. Differences between social strata in birth rates, and their relation to varying standards of living, 226 — Sec. 2. The main cause of the general tendency to lower birth rate is social ambition. Its connection with private property and individualism. Illustration from native-born and immigrants in the United States, 230 — Sec. 3. Is the preventive check being carried too far? Eugenics and race suicide, 234.

CHAPTER 54

VOL. II PAGES

INEQUALITY AND ITS CAUSES 238–256

Section 1. The fact of inequality: distribution has a roughly pyramidal form. Figures indicating the distribution of income for Prussia, for Great Britain, for London, 238 — Sec. 2. The distribution of property, as indicated by probates in Great Britain, by tax statistics in Prussia, 242 — Sec. 3. How far it appears that inequality is becoming greater. Dearth of information regarding distribution in the United States, 245 — Sec. 4. The causes of inequality: differences in inborn gifts; the maintenance of acquired advantages, through opportunity and, above all, through inheritance, 246 — Sec. 5. Inheritance to be justified as essential for the maintenance of capital under a system of private property. Possible limitations of inheritance, through taxation and in other ways, 248 — Sec. 6. The grounds on which private property rests. The utilitarian [illegible] differences in inborn gifts, accumulation, inheritance. The leisure class; its economic and moral position, 251 — Sec. 7. Whatever the eventual changes, private property, inequality, and the leisure class, will long endure, 255.

REFERENCES ON BOOK V 257

BOOK VI

PROBLEMS OF LABOR

CHAPTER 55

TRADE-UNIONS 261–284

Section 1. Introductory. Character of the questions in this book: they involve the weighing of conflicting considerations, and are affected by social sympathy, 261 — Sec. 2. Bargaining power of laborers strengthened by unions. Weakness of the single laborer. Immobility of labor; lack of reserve funds; perishability, 262 — Sec. 3. Monopolistic tendencies of trade-unions of skilled workers; not often of permanent importance. The open union, such as alone can develop among the less skilled, a potent instrument for good, 266 — Sec. 4. Closed shop or open shop? A strong case *prima facie* for the closed shop with the open union, 269 — Sec. 5. The danger of a check to progress and efficiency under the closed shop. Limitation of output; piece work; the standard rate; labor-saving appliances; discipline, 271 — Sec. 6. A division between open shop and closed shop not unacceptable. Grounds of employers' opposition often untenable, 276 — Sec. 7. The scab and the use of violence. The tie-up, 279 — Sec. 8. The unionist movement likely to extend, and entitled to sympathy, 282.

CHAPTER 56

VOL. II PAGES

LABOR LEGISLATION 285-302

Section 1. Labor legislation, like labor organization, aims to standardize conditions of employment. Legislation on the hours of labor for women and children the typical case. Other sorts of restriction. Situation in the United States, 285 — Sec. 2. Why legislation must supplement and support the laborers' own efforts. A great moving force behind it is the growth of altruism, 289 — Sec. 3. Limitation of hours for men comparatively rare. Are there grounds on principle for confining such legislation to women and children? Constitutional questions in the United States, 291 — Sec. 4. The demand for an eight-hour day deserves support. Introduced suddenly and universally, the eight-hour day would mean a decline in product and in wages; introduced gradually, and *pari passu* with improvements in production, it brings unmixed gain, 293 — Sec. 5. Minimum wages introduce no new principle, but present the problem how to deal with the unemployable, 297.

CHAPTER 57

SOME AGENCIES FOR INDUSTRIAL PEACE 303-322

Section 1. Profit sharing affects profits as the residual element. Some modes of applying it. Immediate and deferred participation, 303 — Sec. 2. Profit sharing will not be widely applied unless it pays, by increasing efficiency. Uncertain connection between profits and workmen's efficiency. Importance of the employer's personality, 306 — Sec. 3. Other methods of linking employee to employer: "gainsharing" and "welfare" arrangements, 309 — Sec. 4. The sliding scale, applicable where product is homogeneous. Not in harmony with the general principle of employer's assumption of industrial risks, yet often helpful toward avoiding friction and dispute, 311 — Sec. 5. Arbitration, private and public. Not applicable where such matters as recognition of union or the closed shop are in dispute; but applicable to questions of wages and the like. Private boards imply trade agreements and organized unions. Public boards are usually boards of conciliation, but none the less helpful, 313 — Sec. 6. Compulsory arbitration, carried to its logical outcome, means settlement of all distribution by public authority, and may be the entering wedge to socialism. Possibility that it will remain indefinitely in a halfway stage and not proceed to its outcome, 316 — Sec. 7. Compulsory arbitration in the limited field of "public service" industries presents no such deep-reaching questions, and ought to be applied, 320.

CHAPTER 58

VOL. II PAGES

WORKMEN'S INSURANCE. POOR LAWS 323–345

Section 1. Irregularity of earnings and its causes, 323 — Sec. 2. Provision against accident is feasible through insurance. The German system, the English, the French. The charges, though levied on the employer, are likely to come ultimately out of wages, 323 — Sec. 3. Insurance against sickness no less feasible. The Friendly Societies, the German system of compulsory insurance. The possibility of malingering and the need of supervision, 328 — Sec. 4. Old-age pensions in European countries and in Australia. Are they deterrents to thrift? The pecuniary difficulties not insuperable, 331 — Sec. 5. The situation in the United States as to accidents long chaotic; the need of reform. Rapid spread of compensation for accidents. The political difficulties in the way of this reform and others, 334 — Sec. 6. Unemployment, though it tends to correct itself, is a continuing phenomenon. Difficulties of applying any method of insurance. Possibility of supplementing trade-union out-of-work benefits. The British National Insurance Act of 1911. Relief works, 337 — Sec. 7. Poor laws: the conflict between sympathy and caution. Relief may be liberal where no danger of demoralization exists. For the able-bodied, it needs to be administered with the utmost caution, 342.

CHAPTER 59

COÖPERATION 346–359

Section 1. Coöperation attempts to dispense with the business man. Its various forms, 346 — Sec. 2. Cooperation in retail trading, when done by the well-to-do, of no social significance. When done by workingmen, as in Great Britain, it has larger effects. Methods of the workingmen's stores and causes of their success. The movement elsewhere, 347 — Sec. 3. Credit coöperation in Germany; its methods and results. Other sorts of societies, and development in other countries, 352 — Sec. 4. Cooperation in production would most affect the social structure, but has had the least development. Causes of failure: the rarity of the business qualities, and the limitations of workingmen. The future of cooperation, 355.

REFERENCES ON BOOK VI 359–360

BOOK VII

PROBLEMS OF ECONOMIC ORGANIZATION

CHAPTER 60

RAILWAY PROBLEMS 363–381

Section 1. Railways an instrument for furthering the geographical division of labor. Corollary from this that they are not to the

VOL. PAG

public interest unless they pay, 363 — Sec. 2. Economic characteristics of railways; first, the great plant. Consequent tendency to decreasing cost. Hence also frequency of rapid transition from financial failure to financial success, 366 — Sec. 3. Second, the element of joint cost, both as to fixed charges and operating expenses. Charging what the traffic will bear; classification of freight, 369 — Sec. 4. Justification of charging what the traffic will bear lies in full utilization of the railway equipment, 372 — Sec. 5. The peculiar severity of railway competition explained by joint cost. How far lower competitive rates on long hauls are justified, 373 — Sec. 6. Other consequences of joint cost: flexibility of rates, and difficulty of deciding what is a reasonable rate, 375 — Sec. 7. Chaotic rates in the United States, and concession to favored shippers, partly corrupt, partly the result of competition, 376 — Sec. 8. "Rebates" and the grounds for prohibiting them. Rate agreements and pools as aids in preventing discriminations. Inconsistency of our legislation on rebates and rate agreements, 379.

CHAPTER 61

RAILWAY PROBLEMS (*continued*) 382-

Section 1. Effects of railways on distribution. An unearned increment analogous to rising rent of land, 382 — Sec. 2. Tendency toward concentration of ownership; how promoted by American methods of corporate organization. Overcapitalization and its consequences, 384 — Sec. 3. Stock speculation, stimulated by overcapitalization, has facilitated acquisition of control by the "great operators," 388 — Sec. 4. "Inside management" and its evils, 390 — Sec. 5. What benefits have come from private ownership in the United States, and how far railway fortunes have been earned, 391 — Sec. 6. Increasing tendency to monopoly, and need of public control over rates, 394.

CHAPTER 62

PUBLIC OWNERSHIP AND PUBLIC CONTROL 397-

Section 1. What are "public service" industries? The legal conception less important than the economic; the essential earmark is monopoly, 397 — Sec. 2. The spur of profit necessary for improvements in the arts; hence a preliminary stage of private ownership is inevitable, 401 — Sec. 3. The question of vested rights when public ownership displaces private. "Franchises" should always be for limited terms. Purchase at market value, 403 — Sec. 4. Are there criteria marking some industries as suitable for public management? The tests suggested by Jevons; distrust of public officials underlies them all, 405 — Sec. 5. To secure trust-

VOL. II PAGES

worthy and efficient public officials is partly a problem of political machinery. Some difficulties of public management, as regards the employment of labor and the maintenance of progress, 407 — Sec. 6. The fundamental requisite in a democracy is a generally high level of character and intelligence. In what way corruption is connected with monopoly industries, 409 — Sec. 7. The future of democracy depends on its success in dealing with these industries. Experiments in ownership to be welcomed, especially in municipalities. The prejudices of the business class on this matter, 411 — Sec. 8. Public regulation the only alternative to public ownership. The two types of regulating boards. Publicity as a means of supervision. Overcapitalization. The essential object is to limit prices and profits. The elevation of the standards of private management. Supervised quasi-public management only a halfway stage? 413.

CHAPTER 63

COMBINATIONS AND TRUSTS 419–442

Section 1. Combinations in restraint of trade and the common law rule making them void. Surprising effectiveness of this rule, 419 — Sec. 2. Modern forms of combination in the United States: the "trust," the holding company, the unified corporation. The Kartel in Germany. The fact of monopoly, not the form of combination, the important thing, 420 — Sec. 3. The permanency of combination as affected (1) by the economies of large-scale management; (2) the devices of "unfair" competition, — railway favors, discriminations in prices, factor's agreements, advertising devices. The effective defense against "unfair" competition is not from legislation so much as from large-scale competition, 424 — Sec. 4. Will large-scale competition persist? The pressure from constant accumulation of fresh capital. Potential competition, and the possible emergence of foresighted management tinctured by a sense of public responsibility, 430 — Sec. 5 The possible public advantages of combination lie in the mitigation of industrial fluctuations. The supposed ruinous effect of competition to be judged from this point of view, 433 — Sec. 6. The legislative problems. Federal regulation called for on publicity, capitalization, eventually perhaps on profits and prices, 437 — Sec. 7. The earmarks of monopoly: size, profits, discriminating prices, 439 — Sec. 8. Legislation in the United States. The act of 1890 and its enforcement. The acts of 1914; the Federal Trade Commission, 441.

CHAPTER 64

SOCIALISM 443–459

Section 1. Proposals for large-scale socialism have superseded those for isolated communism. The essence of socialism is economic

transformation; changes in religion, the family, political institutions, are not essential *to its program*. Nor is violent change essential, 443 — Sec. 2. Land and capital to be in public hands; not necessarily public property in every instance. The peculiar problem as to agricultural land. Wages to be the only form of income. Exchange and money in the socialist state, 446 — Sec. 3. Three conceivable principles of distribution: need, sacrifice, efficiency, 449 — Sec. 4. How far public ownership, as adopted in present society, is socialistic; how far labor legislation and the like are so, 454 — Sec. 5. Some current objections to socialism are of little weight; for example, that the huge organization is impracticable, that goods could not be valued, that capital could not be accumulated. Would freedom disappear? 456.

CHAPTER 65

SOCIALISM (*continued*) 460

Section 1. The family and the problem of population under socialism. The Malthusian difficulty a real one, 460 — Sec. 2. Vigor and efficiency among the rank and file. The absence of the power of discharge. The irksomeness of labor, 462 — Sec. 3. Leadership and the ways of securing it. The love of distinction; can it be satisfied by the laurel wreath? Mixture of higher and lower aspects in the love of distinction. The possible growth of altruism, 464 — Sec. 4. The selection of leaders in a socialist state. Genius and originality likely to be deadened, 466 — Sec. 5. Material progress through the improvement of capital likely to be checked. Is a change in distribution alone now needed: can advance in production be neglected? 468 — Sec. 6. The problem is essentially one of motive and character. Human nature and ideals of emulation and distinction are subject to change. Though socialism and current movements of reform rest on the same force, the difference in degree is vast, 470 — Sec. 7. Is socialism to be the ultimate outcome of social evolution? The materialistic interpretation of history and its prophecies. The certainty that change will be gradual and the impossibility of foreseeing how far it will finally go, 473.

REFERENCES ON BOOK VII 478

BOOK VIII

TAXATION

CHAPTER 66

SOME PRINCIPLES UNDERLYING TAXATION 483

Section 1. The essential nature of taxation: no *quid pro quo*. Taxes a sign of wider consciousness of common interest, 483 —

VOL. II PAGES

Sec. 2. Proportional or progressive taxation? This question of justice inextricably connected with the general question of social justice and the righteousness of inequalities in wealth. "Ability" and "equality of sacrifice" are inconclusive principles, 485 — Sec. 3. Should funded incomes be taxed at higher rates than unfunded? 490 — Sec. 4. Can taxes be made higher according to the source or nature of the income? 492 — Sec. 5. Progressive taxation of interest, on the principle of taxing saver's rent, 494.

CHAPTER 67

INCOME AND INHERITANCE TAXES 497–514

Section 1. Income taxes present the problem of progression sharply; yet should be considered in connection with other taxes, 497 — Sec. 2. Income taxes limited as a rule to the well-to-do classes. The exemption of small incomes rests partly on social grounds, partly on administrative expediency, 498 — Sec. 3. The British income tax and the device of stoppage at the source. Declarations of a taxpayer's entire income rarely required. The system not consistent with progression, 500 — Sec. 4. The Prussian income tax as a type of progressive taxation on entire income. Declaration necessary. Conditions necessary for the effective administration of such a tax, 505 — Sec. 5. Inheritance taxes are comparatively easy of enforcement, and lend themselves readily to progression. Carried too far, they check accumulation and the increase of capital, 507 — Sec. 6. Some further considerations on inheritance and income taxes, 510 — Sec. 7. The income tax question in the United States. The constitutional amendment of 1913 and the income tax of that year, 512.

CHAPTER 68

TAXES ON LAND AND BUILDINGS 515–527

Section 1. Taxes on land (*e.g.* an urban site) rest definitively on the owner, and operate to lessen economic rent by so much, 515 — Sec. 2. Taxes on buildings tend to be shifted to the occupier. Qualifications and limitations of this proposition, 518 — Sec. 3. Effects of taxes on real property, — land and buildings combined, 521 — Sec. 4. In the long run, it makes no difference in the incidence of such taxes whether they are first imposed on owner or tenant; but for short periods, it does. Similarly, it is in the main of no concern whether the assessment be on rental or on capital value; though in some respects the two methods bring different results, 522 — Sec. 5. Concealed taxation of workingmen through taxes on their dwellings, 525 — Sec. 6. Taxes on real property should be primarily local taxes, 526.

CHAPTER 69

VOL. II PAGES

The General Property Tax 528-549

Section 1. The general property tax works sufficiently well under simple industrial conditions, 528 — Sec. 2. In complex modern communities it is impracticable. Many incomes arise which do not rest on property; many forms of property are not readily reached; the development of debts and credits, of corporate organization, causes difficulties, 529 — Sec. 3. The rate of taxation important. Its influence in the case of securities. Complete breakdown of the system as to these, 532 — Sec. 4. The taxation of corporations and of corporate securities. "Double taxation" of stocks and bonds. A method analogous to stoppage at the source should be applied. Difficulties of apportionment between conflicting jurisdictions, 536 — Sec. 5. Mortgages and mortgage notes present similar problems, 540 — Sec. 6. Public securities present especial difficulties for a property-tax system. Is it expedient to exempt them from taxation? 543 — Sec. 7. Possible ways of reforming American methods of taxing securities: complete exemption, moderate tax on capital value, tax on the income, 544 — Sec. 8. A question of principle: how far can the taxation of income-yielding property be carried without checking accumulation? 547.

CHAPTER 70

Taxes on Commodities 550-560

Section 1. Direct and indirect taxes. Various ways in which "indirect" taxes are levied on commodities, 550 — Sec. 2. In the simplest case, of a competitive commodity produced under constant returns, a tax tends to be shifted to consumers. Explanation and qualification of this principle, 551 — Sec. 3. Complexities where the commodity is produced under increasing or diminishing returns; where there is monopoly. Cautions to be observed in the application of theoretic reasoning on these topics, 553 — Sec. 4. Taxes on imports present no peculiarities, except as they bring a rival untaxed supply and thus raise the questions concerning protection, 557 — Sec. 5. Taxes on commodities are little noticed by consumers. They are commonly on articles of large consumption, and regressive in their effects. A large and varied list of articles is most easily reached by customs duties, 557.

References on Book VIII . . . .

BOOK V

THE DISTRIBUTION OF WEALTH

CHAPTER 38

INTEREST ON CAPITAL USED IN PRODUCTION. THE CONDITIONS OF DEMAND

§ 1. The word distribution, in the sense commonly attached to it in economic writings, refers to the apportionment of the income of a community among its several classes and members. Wherever industrial development is in any degree advanced, there are owners of capital and of land; there are persons using land and capital, who yet are not the owners, — tenants and borrowers; there are all sorts of workers, ranging in earnings and in social position from the poorly paid day laborer to the prosperous professional man and salaried manager. What share goes to a person who simply possesses capital or land, and what share goes to an individual for his labor, of whatever sort, — these are among the central problems of distribution. A common division of the subject is into four heads, corresponding to four groups in the community whose income is supposed to be governed by different causes: capitalists, landowners, laborers, and finally, business men or active managers of industrial affairs The capitalists are said to receive interest, the landowners rent, the laborers wages, and the business men profits or earnings of management. We need not now consider how far this classification is satisfactory; it suffices to indicate the nature of the new subject on which we now enter.

Neither is it necessary to explain in advance why one or another of these subjects should be selected for first consideration. They are closely connected, and no full understanding of any one can be had until the others also have been examined. We shall begin by considering interest, — that share which goes to the owner of capital.

Let it be recalled that by capital we mean concrete instruments made by man. Land, and like agents provided by nature without application of labor, are excluded from the present discussion of capital. And among instruments made by man, those made with a view to ulterior use in further production — producer's capital — will be first and mainly considered, consumer's capital being also reserved for separate treatment.

§ 2. The essential problem concerning interest can be stated in simple terms. Why should an individual who borrows from another a given quantity of commodities — represented, in any except primitive communities, by a given quantity of money — engage to return, after a fixed time has elapsed, not only what he has borrowed, but something in addition? That the amount borrowed should be returned, seems sufficiently easy of explanation. But why can the lender get the premium also? That premium, as is familiar enough, usually is expressed in terms of a percentage paid each year. The borrower engages to pay back, not only the principal, but five per cent or thereabouts in addition for each year that elapses, and a proportional percentage for each fraction of a year. To ascertain why this additional percentage is paid, is to solve the problem of interest.

The fact that the transaction in modern communities takes the form of a loan of money and a repayment of money with interest, has often led to the notion that it is peculiarly connected with money and arises from the nature and functions of money. Usually this notion takes the form of reasoning in a circle. People are familiar with the everyday practise of lending at interest; they say that money is "worth" so much, meaning that it can be lent at some annual rate; and they argue that the borrower must pay this rate in order to get the money. What more simple? Or they say vaguely, with Shylock, that money "breeds" interest; which again is a statement of the problem, no solution. A little reflection shows that, here as elsewhere, money serves simply as the medium of ex-

change. What the borrower wants is not the money itself, but that command over commodities and services which money gives. He wishes to buy commodities, either for his own immediate use, or for use in operations of production; and in the latter case (the one to which the present discussion is more particularly directed) he wishes to procure machines, materials, and the means for paying laborers whom he hires. And when he returns the money, plus the premium, he gives back to the lender the same command over commodities which he had received, and something in addition; he gives back more commodities than had been lent him. If there were no such thing as money, the same sort of transactions would take place; precisely as, given the division of labor, the exchange of different sorts of commodities would take place under barter in fundamentally the same way as with the use of a medium of exchange. Under barter both transactions obviously would be managed with much greater difficulty. The medium of exchange makes borrowing easier, as it makes exchange easier; and it makes possible much borrowing and much exchanging which otherwise would be impracticable. The explanation, however, of both sets of phenomena is not to be found in the use of money, but in the nature of the operations which it facilitates.

We may brush aside, not only the notion that interest arises from the use of money, but that the rate of interest depends on the quantity of money. More money makes higher prices, not lower interest. The connection which does exist between the rate of bank discount and the quantity of money held by banks has been sufficiently explained;[1] this bank rate oscillates above and below what may be called the true rate of interest, — the return on steady investments. In the exposition which follows, this essential rate of interest will be had in mind.

§ 3. Interest, then, appears as the result of an act of exchange by which a quantity of money (or commodities) now in hand is given for a greater quantity of money (or com-

[1] Book III, Chapter 25, especially § 2.

modities) to be returned in the future. The excess or surplus thus emerging seems to be got for nothing; there is no obvious equivalent for the premium or interest. Yet an exchange of something for nothing is not to be expected in the long run. Two questions present themselves: on the one hand, why is the borrower, whom we may regard as the purchaser, willing to pay this excess; on the other hand, why is the lender, or seller, able to secure it for himself? In other words, what are the conditions of demand, represented by the borrowers, and what the conditions of supply, represented by the sellers? These we will consider, in the order stated, in the present and the following chapter. The conditions of demand we shall analyze first with reference to those borrowers who are engaged in operations of production; since we are considering first the case of interest derived from producer's capital.

Some indication of the conditions of demand has already been given. In a previous chapter[1] the nature and functions of capital were described. It was pointed out that the use of capital means production spread over time. Production with capital has been aptly described, in Böhm-Bawerk's phrase, as indirect or roundabout production. Labor is first applied to making tools, collecting materials, perfecting means of communication; finally, at the close of preparatory steps which may be long and arduous, the enjoyable product emerges, and emerges in much greater abundance than if labor had been applied directly. The mine, the railway, the steamship, the iron works, the factory, the warehouse, the wholesale and retail store, all stand for a prolonged and time-requiring process of production.

Further, production in the advanced communities of modern times is "capitalistic" in another sense: there is a class, separate in the main, of capitalists. The long-maintained application of labor in successive steps is possible only if at the outset there has been a surplus, — if there has been saving and accumulation in some form. The persons who do the saving

[1] See Book I, Chapter 5, §§ 1–3.

and possess the surplus are commonly, though not necessarily, a different set from those who do the labor. They hire the laborers in the various stages of the productive operations. The creation of capital, and the emergence of interest as a distinct element in distribution, are alike the consequences of the double process of surpluses saved and of labor applied in roundabout ways.

We have now to note more explicitly that this process means an increase in the productiveness of labor. The great modern flour mill is more efficient than the modest grist mill of former times. Per unit of labor applied, more is accomplished. To make an accurate comparison of labor product between two such cases would call for intricate computation. On the one hand, the modern mill stands for much more of preparatory labor. On the other hand, it is usually more durable, and the labor applied to making it continues to play its part through a long period, until the mill is finally worn out and discarded. The later labor in the series — that done by the current workers in the modern flour mill, who turn out their thousands of barrels a day — seems much more effective than that of the old-fashioned miller; because we do not ordinarily think of the preliminary labor embodied in the plant as engaged in milling. That, even so, the efficiency of all the labor engaged, of earlier as well as of later date, is greater, is shown by the simple comparison of prices: flour is vastly cheaper (that is, the excess in price of flour over grain) than in former days. So in the railway: there has been an enormous application of capital — that is, of previous labor — with an outcome of transportation rates so low as to prove that, taking account of all the labor of construction, maintenance, and operation, its efficiency is immensely greater than that of the simpler instruments of pack horse and wagon.

This consequence has sometimes been stated by saying that capital is productive; a phrase which must be used with care. The strictly accurate statement is that labor applied in some ways is more productive than labor applied in other ways.

Tools and machinery, buildings and materials are themselves made by labor, and represent an intermediate stage in the application of labor. Capital as such is not an independent factor in production, and there is no separate productiveness of capital. When, in the following pages, the productivity of capital is spoken of, the language must be taken as elliptic, expressing concisely the result of the capitalistic application of labor.

All this analysis of the relation of labor to capital and to savings leads, again, to the proposition that all the operations of capitalists resolve themselves into a succession of advances to laborers.[1] Some persons have a surplus, and set it aside for investment, — they are the capitalists pure and simple. Still other persons borrow this surplus (very likely using also available means of their own) and hire laborers to make tools and materials, to carry on all the stages of production, and so produce in the end more consumable commodities than have been turned over to the laborers. The laborers as a whole produce more than they receive. Those who borrow, and then hire the laborers, can afford to pay back more than they have borrowed. This is the process by which interest on capital used in production comes into existence.

§ 4. Let it be supposed now that at any given time the capitalistic ways of production — the applications of tools, machinery, materials, and the like — have been so settled and established as to become familiar to all. Let it be supposed also that they are equally available for all; that no one has a monopoly of any particular form; that all who wish to use them are in unfettered competition with each other. No borrower will then be able to secure a greater advantage than any other from the use of savings, in getting control of any particular kind of capital. Competition will bring the return in all channels of investment to the same level. What will determine that uniform level?

All the constituent parts of capital, though they will yield the

[1] See Book I, Chapter 5, § 5.

same return to those applying them, will not necessarily affect to the same degree the productiveness of labor. Some may be, and almost surely will be, more helpful in production than others. Imagine that a community, once in possession of a stock of tools and appliances, is compelled to part, by successive steps, with installments of this capital. Clearly it would first relinquish those parts which contributed least to the efficiency of labor, and then, as more and more had to be given up, would relinquish others in the inverse order of serviceableness. It would reserve to the very last those constituents of capital — that is, those means of roundabout production — which added most to the efficiency of labor. These means — the last to be given up, the first to be used under existing conditions — would probably be, on the one hand, the agricultural processes which, in the temperate climate, involve seasonal operations, such as seed and farming tools, and about a year's surplus of food; and, on the other hand, the metallurgical processes which yield iron, the prime requisite for almost all tools. These, the most effective forms of capital, have not necessarily been the first historically. The progress of invention may have brought them in at a later date than others of less serviceableness. But, given various appliances that have come to exist side by side, some will be more effective than others, and, in case of inevitable curtailment, would be the longest retained.

Under such conditions the gain, or premium, or interest, which the owners of capital will secure, will be determined by the least productive use of capital; or, to be accurate in language, by the addition to the ultimate product of labor which results from the least effective phase of the roundabout or capital-using process. Those who use capital in ways more effective than the least cannot retain the superior gain for themselves. Since all who have capital at command can turn to these more effective ways, competition will prevent any one set of persons from securing especially high gains from them. It is the effectiveness of the last installment of surplus or capital (last

in the order of productiveness) that determines the rate of gain for all capital. Or, to put the same proposition in other words, the return to capital depends on its marginal productivity. "Productiveness" and "productivity" are used, of course, in the elliptic sense already explained.

It may be asked, Does the productiveness or serviceableness of *all* forms of capital descend to that of the marginal forms? An equalization of the return to owners of capital takes place; does an equalization of productivity also take place? Not necessarily. The outcome is like that which we have found, in discussing the principles of value, as to the utility and the price of the several constituents in the supply of an enjoyable commodity.[1] Though all the units of a supply sell in the market at the same price, not all have the same utility. There is such a thing as consumer's surplus. Similarly, though the return to the owners of all the constituents of capital is under free competition the same, the contribution from all to the community's well-being is not the same. Some remain more serviceable than others. And the difference in serviceableness shows itself in the same way as in the case of the utilities from enjoyable goods, — it affects consumer's surplus. The more effective uses of capital lead in especial degree to greater abundance of commodities, to ampler provision of some sorts of utilities, and so to wider satisfaction of wants in the community at large.

A similar principle to that which underlies the theory of value thus underlies the theory of capital. Marginal utility determines the current value of commodities; marginal productivity determines the current rate of interest. There are utilities in goods (and services) greater than at the margin. There are contributions from different forms of capital to the social income greater than at the margin. These surpluses the individual owner cannot keep; the community at large enjoys them in the form of consumer's surplus.[2] And the same sort of

[1] See Book II, Chapter 9, especially §§ 3–6.

[2] Compare the pregnant passage in Jevons, *Theory of Political Economy*, p. 277. A contrary view is implied in Clark, *Distribution of Wealth*, Chapter XXI.

difficulty which we found in measuring consumer's surplus as to value and utility would appear if we endeavored to measure the same sort of surplus as to capital and its varying effectiveness. What constituents of capital would be longest retained, and how great the effectiveness of this most precious remnant would be, we cannot possibly gauge. We can only rest assured that differences in the degree of gain there are, and that society as a whole profits greatly through securing all forms of its capital at the same rate that it pays for the least advantageous forms.

§ 5. Some of the most acute economists of our day[1] have stated this part of the theory of capital and interest in different terms, though with a conclusion not in essentials very divergent. Briefly, their view is that by a resort to more and more capitalistic or roundabout ways of production, the output per unit of labor can be indefinitely increased. But this increase does not take place continuously at the same pace. There is a tendency to diminishing gain, or diminishing return; a tendency to a decline in the *rate* of increase in production. Add more tools and appliances — that is, do more and more labor of preparation, make your total process of production more prolonged and elaborate — and you will always get a larger final output. But the increase in the productiveness of labor, great in the first stages of this capitalistic way of applying it, becomes less in the later stages. There is believed to be no limit to the heightened efficiency of labor due to marshaling it over time and elaborating machinery and materials more and more. The obstacle is like that in pulling a stout rubber band: it can always be stretched a bit more, but each additional application of force means a lessened effect.

In this view, it will be seen, differences in productivity and marginal productivity appear not only on taking a cross-section of industry at a given moment, but in the development of industry over the course of time. The tendency to diminishing gain in efficiency may indeed be counteracted by inven-

[1] For example, Professors Böhm-Bawerk, Clark, and Carver.

tions and improvements. But in the absence of such progress, the marginal increase of gain tends to sink and so, too, the rate of return on capital; and it sinks gradually and with some degree of regularity.

It would follow as a corollary that the application of capital can be increased indefinitely without bringing a cessation of return in the way of interest to the owner of capital. Additional installments could always be used to some advantage; there would always be some marginal productivity. Interest, in other words, would persist indefinitely, notwithstanding the utmost growth of accumulation. Whereas, in a more skeptical view, the indefinite increase of savings and of capital may cause the point of satiety to be reached. Unending increase in the means for applying preparatory labor may bring difficulty, nay impossibility, in using the savings to advantage; and then, so far as the forces of demand determine interest, it will be brought down to *nil*.

Like other problems bearing on the distribution of wealth, this must be confessed to be unsettled. To enter on a full discussion of the trains of reasoning involved, would pass the compass of the present book. I will present concisely my reasons for hesitating to accept a general principle of diminishing returns in the applications of capital.

The increase of tools and instruments may be supposed to take place in two ways: either by the addition of more tools of the sort already in use, or by the addition of new kinds of tools. Mere duplication of familiar tools would seem to promise little or nothing in the way of greater productiveness. Twice as many saws or planes for each carpenter, twice as many looms for each weaver, twice as many locomotives for each engineer, — such a proceeding does not mean that more will be accomplished by the carpenters and weavers and engineers. It means an embarrassment of riches. Of the complicated machinery of a great factory this would seem to be true also. To run this machinery, a certain staff of operatives is required, adjusted to it by nice experiment and calculation.

Duplicate the whole outfit, and there will be no one to take charge of it. The staff can utilize no more than is already on hand.

More difficult is the problem as to the second way in which the additions to capital may be supposed to take place. Here it is assumed that there are not more tools of the same kind, but tools of a more elaborate and complex kind. With greater savings and greater possibility of applying labor in advance, capital takes by a quasi-automatic process a different form: not two saws, but one larger and better saw; not two locomotives, but one heavier and more powerful. The mere fact of greater present resources available for investment causes the roundabout operations to be extended, the time of the whole process to be prolonged. Plant becomes larger, machinery more complex and more nearly automatic, materials are heaped up in more varied supply. Then product ultimately becomes greater; but in the rate of increase there is supposed to be a tendency to diminution.

It is the quasi-automatic or predictable character of this process of elaboration that seems to me doubtful. The more "capitalistic" application of labor does not necessarily bring an increase in efficiency. Where it does bring such an increase, the more prolonged preparation may be effective at the same rate, or at an increasing rate, or at a decreasing rate. The outcome depends on the progress of invention, concerning which no rule can be laid down.

It is true that during the last century and a half, in the period since the Industrial Revolution, the progress of the arts has been precisely in the direction of making appliances which require time and labor, and which thereby greatly increase the eventual productiveness of labor. Nor is there any indication that progress of this kind will cease. The history of the last few generations, and the prospects for the next few, support the proposition that the increase of savings and of capital has brought and will bring greater efficiency of labor without visible limits. But this has been due and will continue to be due to

a host of projectors and inventors, to a succession of steps each one of which is at the outset more or less doubtful. How great such progress will be, and how long it will continue, cannot be predicted. The possibility of an indefinite use of savings and of an indefinitely increasing effectiveness of capital is not a tendency inherent in industry, but a fact of comparatively short experience in the modern world.

To put the same problem in another way: the roundabout or capitalistic process may be supposed to adjust itself to the supply of present means (savings); or the supply of present means may be supposed to adjust itself to the roundabout process. The first is the view of those who maintain the quasi-automatic transformation of capital as it increases, and the tendency to diminishing returns as it is transformed into more complex shapes. The second seems to me the view more in accord with historical fact. The progress of invention has taken the direction of more elaborate and complex capital; hence there has been the possibility of using a larger and larger volume of savings in productive ways. The supply of savings, as will appear in the next chapter, is highly flexible. It has taken advantage of all available opportunities for investment, and will continue to do so; it has enabled factories, machinery, railways, steamships, electric appliances, to be made as fast as inventors have shown the way to the effective use of these forms of capital. It is true that in this matter, as in so many others dealt with by the economist, there has been an interaction of causes; none the less it is more true to say that the progress of the arts has made possible the vast investment of savings than that the great volume of savings has brought about the progress of the arts.

But the differences in opinion on this point do not affect the main conclusion stated above, — that, at any given period, the rate of return on capital depends on the gain in productiveness from the least effective part of the capital. So far as this proposition is concerned, there seems to be substantial agreement among modern economists. Whether or no it is believed

that there is a really separate productivity of the capital as distinct from the labor, and whether or no it is believed that the differences in the productivity of capital show themselves through a process of diminishing returns, it seems to be agreed that the factor which determines the rate of interest on capital used for production (so far as it is dependent on demand) is the gain in efficiency or output accruing with the last or marginal installment of capital.

CHAPTER 39

INTEREST, *continued.* THE EQUILIBRIUM OF DEMAND AND SUPPLY

§ 1. We turn now to the conditions of supply for capital, and to the equilibrium of supply and demand. The rate of interest, like the value of a commodity, is settled at any given time chiefly by demand. But in the long run the variations in supply must have their effects also. What is the situation of those persons who have a surplus of present means, — the lenders?

If the accumulation of a surplus were in no way irksome, the supply of present means or savings would increase rapidly and indefinitely under the inducement of a reward in the way of interest. So long as borrowers were willing to pay a premium — to return to lenders more than had been supplied by the lenders — these latter would accumulate more and more, and their increasing savings, put at the disposal of producers, would allow greater and greater advances to laborers. Assuming the arts to remain the same, and no new ways to be found for increasing the productiveness of labor by more elaborate implements, the stage would be reached when the additional advances to laborers would bring no addition to the output. The marginal productivity of capital would then be *nil,* and interest on capital would disappear. If, in fact, this stage is not reached, the reason must be that accumulation and saving do not continue indefinitely unless there be some inducement offered.

§ 2. Does saving — the putting by of present means — necessarily depend on a reward in the way of premium or interest? It is certain that this is not universally the case. There is a considerable volume of saving which would take

place even if there were no premium, — if the amount paid back in the future by the borrower, were no greater than the amount now supplied by the lender. Nay, a situation is conceivable under which the familiar relation would be reversed, — under which not the borrower, but the lender, would pay a premium. On the other hand, there are savings which would not take place at all except for the reward which is commonly paid by the borrower as interest. These gradations in the conditions under which accumulation and lending take place call for some detailed consideration.

One extreme, just referred to, is of theoretical concern rather than of practical importance: the case of the lender who is so desirous of providing for the future that he is willing to accept at a later date, as the price of the safety of his possessions, a *less* sum than he parts with in the present. This situation might conceivably arise where means were very abundant in the present and where a future with scantier means was expected. Thus, a man in his prime, with good earning power but without income-yielding investments, knowing that old age must come, might set aside a considerable amount from his present income in order to be assured at a later date of an even smaller sum. At forty, $200 might be saved from an ample income with comparative ease; and it is conceivable that it would be saved cheerfully in order to have, at the age of seventy, the certainty of $150. Hence, if no other choice presented itself, an exchange of $200 at forty, for $150 to be received thirty years later, would not be out of the question. There might be negative interest, so to speak. But another very simple choice in fact presents itself. The $200 may be set aside *in corpore*, tucked away, and kept until the later date when the need becomes greater. It may be hoarded, without being lent or invested. This, of course, is feasible only if there be some kind of commodity which does not deteriorate, which can be easily safeguarded, and which maintains its value. If men lived in primitive conditions, and all incomes were received and managed in kind — if the actual bread and meat had to be put aside

in order to provide for the future — a bargain for giving a greater amount of such perishable things in the present for the guarantee of a less amount in the future is conceivable. But money brings an easy alternative between present and future use. Given ordered government and security, — given also stable value of money, — then money in hand is as good as money in the future. Specie or its equivalent in paper money can be hoarded with little trouble; elaborate safe-deposit boxes are to be had at a charge insignificant in proportion to what they will contain. Hence we may set aside as negligible the possibility of negative interest. The present will command at least par in the future. It is this sort of reasoning that led Böhm-Bawerk to lay down, in somewhat technical terms, the general proposition that present goods are always at least equal in value to future goods of like kind, — because a choice exists between present and future use.[1]

But, though the cases in which interest might be negative may thus be neglected, those in which it might be *nil* are many. A great mass of savings are made quite without the need of stimulus in the way of premium or interest. In such cases present means would be exchanged for future means at par. The greater part of the deposits in savings banks in most civilized countries are probably of this nature. A vast number of persons have acquired the habit of providing against a rainy day. Where a secure and convenient depository is offered, they set aside something from current means as a safeguard against future emergencies. If interest is paid on such savings, it is welcome enough; but the savings would be made in any case. Not only deposits in savings banks, but the accumulations of life insurance companies from annual premiums partake in some degree of this character. Provision for dependents, by annual payments through the mechanism of insurance, would

[1] It is still conceivable that, even with most perfect facilities for hoarding, a few highly timorous persons would pay negative interest for a supposedly unquestionable guarantee of the future; just as a few timorous investors nowadays insist on buying government bonds bearing very low interest, rather than the safest of privately issued securities.

be made even if these annual payments were not augmented, as in fact they are, by the interest added to them by the insuring companies. How large is the proportion of savings bank and life insurance accumulations made with this sole motive, it is impossible to measure; but the proportion must be great.

§ 3. On the other hand, there are accumulations that will not be made except for the stimulus of a reward. Some receipt of interest is indispensable for a large part, probably the larger part, of the savings made in modern communities. Yet this stimulus does not need to be applied in its full strength over the whole range. Much saving that is done with a view to some return would yet continue even if the return were lowered. Other saving, again, requires the full current rate for its continuance. The differences between the various degrees of stimulus required (*i.e.* the various rates of return) are no less noteworthy than the broad difference between some return and no return at all.

Suppose the rate of interest, which for many generations has been somewhere near four or five per cent, should drop very sharply to two per cent, or one per cent. No doubt many persons would cease to save. But many others, especially those with large present means,—those who have enough and to spare in any case,—would maintain their accumulations unchecked.

Perhaps the most characteristic and quantitatively important case of this sort is that of the successful business man. He "makes money," in the current phrase; which means that his earnings considerably exceed his habitual living expenses, and that, without sensible deprivation of present pleasures, he puts by something for the future. The aim of such men usually is to accumulate a competence or a fortune. In a country like England, the founding of a "family" is a common aim: the transmission to children of a sum sufficient to enable them to take their place among the leisure-class idlers, association or matrimonial alliance with the gentry and aristocracy, eventually, if there be money enough and some address, a knighthood or

even a peerage. In all modern communities the worship of "society," perhaps the most ubiquitous phase of the deep-rooted and universal love of distinction, contributes powerfully to accumulation. No doubt, among the active men of affairs, other motives play their part, — the love of power, the impulse for activity, mere imitation and emulation. Certain it is that money-making is impelled by very complex motives. Among these no specific rate of return on accumulation plays a dominant part.

It has been suggested by some writers that within a considerable range a decline in the rate of interest, so far from checking accumulation, would increase it. Many persons among the well-to-do look forward to providing a settled income for the future, either for themselves on their retirement from activity or for their widows and children. In order to provide a "satisfactory" income of say $5000 a year, a capital sum of $100,000 must be put by if the rate of interest is 5 per cent. But if the rate is 2½ per cent, double the sum must be put by in order to bring the same income. On this sort of reckoning, the lower the rate of return, the greater will be the amount accumulated and invested.

Such reasoning, however, cannot be pressed far. No doubt there are cases in which a decline in the rate prompts a wish to get together a larger capital sum. But a wish is very different from a deed. For the immense majority of men it would be a very difficult matter to double the amount accumulated. Among those who have very large current incomes but still wish to accumulate a capital sum, — the small number of business men and professional men whose earnings are high, — it may be true that a decline in interest will increase rather than lessen savings. But most men who are accumulating with a view to building up a "competence," cannot with ease increase their savings materially, not to mention doubling them. There are constant and pressing demands of the moment, innumerable tempting ways of spending money at once. A decline in the rate of interest is quite as likely to lead

to a readjustment of the scale of what is a "competency" or a "satisfactory" income in the future, as it is to induce greater savings. In the supposed case, the man who had looked forward to providing for himself or his family an income of $5000 on a capital of $100,000, is likely to say, when the rate falls to two and one half per cent, — then an income of $2500 must suffice.

On the other hand, with many individuals and for great amounts of savings, the usual relation of price to supply appears, — namely, a higher price leads to an enlargement of supply, and a lower price to a lessening of supply. Stated with reference to interest and capital, the proposition is that an increase in the rate will bring more savings and more capital, a decrease less savings and less capital. No one would doubt that if the rate rose to twenty per cent, many sums would be set aside and invested which at a lower rate would be spent for immediate satisfactions. Conversely, if the rate were to fall to one per cent, or to one half of one per cent, many sums would be spent at once which at a higher rate are saved. Between these possible extremes is the current rate of something like four or five per cent; and among the various savings there are some for which that current rate is just enough to induce the sacrifice involved.

Thus we reach the conception of a margin. There are intramarginal savings, and marginal savings; and also, it may be added, extramarginal or potential savings. There are the willing and almost spontaneous savers, — those whose motives for accumulation are so strong that they would continue even if there were no return at all. There are the less spontaneous but still eager savers, who need the stimulus of some return, but would go on even though that return were lower than the current rate. There are the marginal savers — cool and calculating persons we may conceive them — for whom the existing rate of interest is just enough to induce the sacrifice of present for future. And finally there are the extramarginal savers, who do not now accumulate, but would be led to do so if the return were to increase.

In strictness, we should speak not of more or less willing

savers, but of installments of savings more or less easily induced. The same person may be very differently disposed as regards different parts of his accumulations. Something he may put by in any case for a rainy day; something more he may put by from the love of social distinction, or from other motives in which, though the expectation of some return plays a part, a higher or lower rate is not decisive. Something more, finally, he can be induced to save only under the stimulus of a return at the existing rates. The gradation runs not by individuals, but by installments. There are marginal savings, even though there is perhaps no individual all of whose savings are at the margin.

§ 4. The outcome of the discussion of demand (carried on in the preceding chapter) and supply (in the present chapter) can be stated in simple form under the theory of value. The several installments of savings are to be had at various rates, some for a small reward, some for a larger reward. The case thus is one of varying supply price, coming under the principle

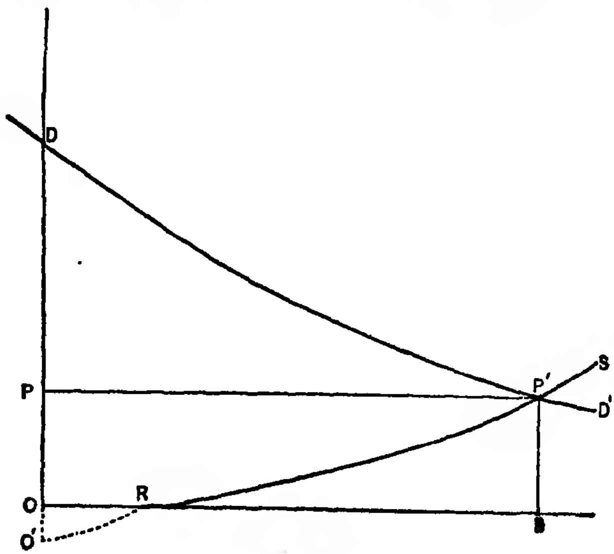

FIG. 1.

of increasing costs. A diagram of the familiar sort will illustrate the situation.[1]

The conditions of demand are indicated by the line *DD'*, whose descending slope represents the diminishing productiveness of the several installments of capital. The ascending line *ORS* indicates the conditions of supply, — the increasing prices which must be paid in order to induce the several installments of savings which enable the capital to be forthcoming.[2] This line in its earlier part does not rise above the base line *OB*. That is, some savings would be made, even if nothing were paid in the way of interest on capital. Nay, if we believe that the disposition and incentive to provide for the future is so great among some savers that a smaller sum in the future will be accepted by them in return for a larger sum in the present, the line in its earlier part will sink below the base line, and will begin at *O'*. There would be negative interest if the rate were determined solely by the competition of these persons. As we reach installments as to which the disposition to save is less and less strong, and more and more must be paid in order to induce accumulation, the line rises. Finally, we reach the marginal saver at *B*. The price at which he is willing to save corresponds to the gain which is secured from the use of the marginal increment of capital. Here equilibrium is reached; the rate of interest settles at a point where the marginal productivity of capital suffices to bring out the marginal installment of saving.

Evidently those persons whom we have designated as spontaneous savers — those who are disposed to save under any circumstances — gain something in the nature of a surplus. The total amount paid as interest is indicated by the rectangle *PP'BO*. There is a large amount of savers' surplus or savers'

[1] Compare Book II, Chapter 13.

[2] The sacrifices or disutilities involved in the installments are not necessarily measured by the prices calling them out. Those savings which would be made without interest (rainy day savings) may involve serious sacrifice. Here, as in Book II, the supply schedule relates to the matter-of-fact question of the price which must be paid in order to call out a given supply.

rent, indicated by the area *ORP'P*, or possibly *O'RP'P*. For those who would save in any case, the whole of the interest which they receive is in the nature of surplus. For those who would be willing to save at a smaller rate than that current, a part of what they receive in interest is surplus.

How great now is this surplus in modern civilized communities? or, in other words, what is the conformation of the line *ORP'*? In Figure 1 it is represented as rising slowly from *OR*, and approaching *P'* somewhat steeply; indicating that much saving would be done for less than the marginal or market price, and that there is a large amount of savers' surplus. But it is no less possible that *ORP'* should rise steeply from *OR*, and then move nearly parallel to *PP'*, as in Figure 2;

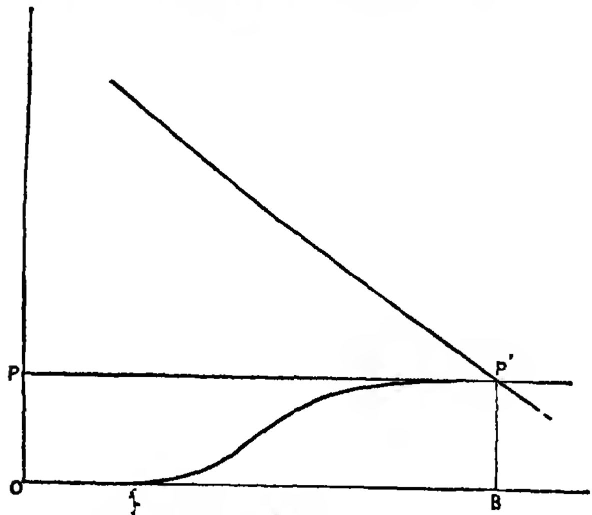

Fig. 2.

indeed, it may be coincident with *PP'* in the latter part of its course. In other words, a large part of the saving may need the stimulus of the whole current rate of return, or nearly the whole, and savers' surplus may be correspondingly less in amount. And a further question arises as to the conformation

of the supply line beyond P'. Suppose there is a general increase in demand (which would be indicated by a shifting of the demand curve to the right),—will the rate of interest permanently rise, or will the supply of savings and capital rapidly extend and bring the rate of return back to the amount BP'? In other words, is BP' capable of being continued to the right indefinitely, prolonging the horizontal line PP' beyond P' without rising in its further course? To some of these questions our answers must be quite uncertain; and even for those which we can answer with some assurance we must rely on general observation rather than on any accurate data.

As has already been intimated, it is tolerably clear that there is much of savers' surplus; but how much, it is impossible to say. One might hazard the guess that the line ORP' has some such conformation as is shown in Figure 2; that, after lingering for a part of its length along OB, it rises gradually to a point near PP', and in the latter part of its course runs nearly parallel to PP' or coincident with it. Thence it would follow that a decline in the demand for capital, unless very great, would not sensibly affect the rate of return on it; since the decline in the rate would check many savings which were at the margin or near the margin, and hence would bring about a decline in the supply of capital. No test of this kind, however, is likely to be applied in modern communities. The demand for capital has grown enormously during the last century or two, and there is no indication that it will cease to grow in the future. In other words, the gain from the use of more and more capital in production has been great, and promises to continue great. The progress of invention and of improvement in the arts has steadily moved the line DD' (at least in its lower reaches) to the right; it has never shifted the line to the left. At the same time, the response of the supply of capital has been rapid and sure. Notwithstanding the vast increase in demand, the rate of interest has remained, on the whole, singularly even; indicating that, so far as the extension of ORP' toward the right goes, it has been prolonged, and

probably will continue to be prolonged, without any permanent tendency to rise.

§ 5. The steadiness of the rate of interest during the vast changes since the industrial revolution of the eighteenth century is a remarkable phenomenon. Holland and England were able to borrow in the middle of that century at about three per cent. Since then the rate has fluctuated between a minimum of something like three per cent and a maximum of something like six per cent. In new countries it has tended to be higher than in old countries; and in times of activity and of hopeful investment it has been higher than in times of depression. Great wars, with their consequence of heavy public borrowing (of which more will be said presently), have raised the rate on occasions; then it has slowly declined as the normal conditions of peace have been gradually restored. During the first three quarters of the nineteenth century the rate, in older countries, was usually in the neighborhood of four and five per cent, and in newer countries, six per cent or a trifle more. During the last quarter of the nineteenth century it sank to three and four per cent in older countries, five per cent in newer. Since the opening of the twentieth century a rise has again appeared; how long it will maintain itself, cannot be predicted. We are considering here, it need hardly be said, not the fluctuating rates of interest on short loans, but the long period rate on permanent investments. The trend of this rate, to repeat, in view of the extraordinary increase alike in the demand for capital and in the supply of capital, has been remarkably even.

From this it is perhaps not an unjustified inference that there is a large volume of savings at the margin. The steadiness of the rate of interest through so long a period of striking changes both in the uses and in the accumulation of capital, would seem to point to a steadying cause, — a marginal supply price to which the rate of return on the whole has adjusted itself. That supply price, to be sure, is likely to be affected in the future by the very fact of large accumulation, or at least by those general industrial and social conditions which accom-

pany large accumulation. The increase in the number of persons belonging to the well-to-do classes, and in their incomes, causes saving and investment to be greater in volume and to entail less sacrifice. The marginal supply price may sink in the course of the next twenty or fifty years to some such rate as two per cent. But the experience of the last few generations makes a greater decline improbable.

§ 6. Whether or no there be a steadying cause of the sort just mentioned, the rate of interest for long periods — decades at a time — depends on the demand for capital with reference to a supply which is constantly and quasi-automatically increasing. It depends on a race between accumulation and improvement.

Accumulation proceeds fast, and promises to continue to proceed fast. It threatens constantly to increase the supply of savings and of capital to the point where a decline in the return must set in. So ingrained is the habit of accumulation among the prosperous classes of modern society, that it seems to proceed irrespective of the rate of interest. Only over considerable periods and after a long disenchantment will a lessening of the return check its unceasing march. How soon and how completely such a relaxation of its advance would take place, we cannot say. Neither can we say with what gradations the decline in interest itself would take place. If there is a general and far-reaching principle of diminishing returns, the process would be a slow one; nay, if that principle is of indefinite application, interest never would quite disappear, however vast accumulation might be. If there be not this supposed possibility of always using more and more savings in productive investment, the stage of vanishing interest would be reached at a comparatively early date. All this, on the supposition that accumulation proceeds irrespective of the return, and that there are no improvements in the arts. If the reasoning of the preceding sections is sound, accumulation will be relaxed long before the return vanishes; yet reluctantly and haltingly, and with a constant pressure from the continuing offerings of those who now enjoy a savers' surplus.

In one respect there will always be an opening for the use of additional savings, even under static conditions, — namely, through the increase of population. Additional laborers need to have an additional supply of the familiar kinds of apparatus. Very few modern countries have stationary numbers. France is the only large one whose population fails to grow. In most communities, numbers increase. In so far there is obvious opportunity for the employment of more savings.

But in the main the way in which the increase of savings can find escape from its difficulties is through the parallel advance in the arts, calling for more and more elaborate forms of capital. Savings in civilized communities easily outstrip the growth of numbers, even in a country of rapidly swelling population like the United States. Hence, to repeat, the race is between improvements and accumulation. Given continued improvements calling for more and more elaborate plant,—more of time-consuming and roundabout applications of labor,—then savings can heap up, and a return still be secured by the owners of capital. Such has been the course of industrial history for the last century and a half. Such, also, is apparently to be its course at least for another generation or two.

CHAPTER 40

Interest, further Considered

§ 1. Spendthrift loans, though far less important in modern times than those for use in production, continue to play a part. Individuals and public bodies still borrow to satisfy needs of the moment, hoping to repay in the future from some extraneous resource. Pawnbrokers' loans are of this sort on a petty scale; the borrowings of nations for the conduct of wars are so on a great scale.

Such loans introduce no new principle concerning the play of demand. There are gradations in the demands of the various borrowers. Some have pressing needs, or are much tempted by opportunities for immediate expenditure. Others have needs less pressing, or more caution and foresight. If we suppose a fixed supply of present means, such as the lenders offer, and suppose loans of this kind to be the only ones, the rate of interest, under effective competition, will settle at the point determined by the least eager among the spendthrifts, — by marginal utility among the borrowing consumers. If we suppose this demand for loans to be added (as in fact it is) to the demand for productive uses, the modification of the conclusions reached in the last chapter will be simply a quantitative one. There is an additional opening for the lenders, but no essential alteration in the gradations of demand or in the play of the forces by which the emerging rate of interest is settled.

The most striking peculiarity in spendthrift loans is that so often there is no such thing as unfettered competition, no such thing as a prevalent or competitive rate determined at the margin. The ignorance and the necessities of borrowers, their inability to pause and inquire what terms can be got, frequently

cause "unfair rates" and "extortion,"—phrases which signify here, as they commonly do also when used of the prices of goods, that the rates which would result from active competition are not in fact attained.[1]

Consider pawnbrokers' loans, for example. The borrowers are usually in immediate need, often timid, ignorant, and anxious for privacy. They are likely to accept hurriedly such terms as are offered at the first place where application is made. So strong is the general belief that the resulting bargains bring an undue advantage to shrewd and unscrupulous lenders, that public authority in civilized countries often regulates the transactions. Sometimes the rate of interest is prescribed, that is, a maximum is set; and detailed regulations are made for the keeping of books and accounts and concerning the mode in which the eventual sale of pledges shall take place. Sometimes, as in France, public pawnbrokers' shops are established, where advances are available at reasonable rates (that is, at something like the competitive market rate). Allowance, of course, must be made for the risks involved, and for the heavy expenses of administration. A rate of ten or twelve per cent on pawnbrokers' loans, after account is taken of expenses, amounts to only a moderate net rate. But much more is often charged than suffices to pay all expenses, to offset risks, and to yield a sufficient return for the lender's capital and labor; hence the occasion for regulation by public authority.

In most semi-civilized communities, the village usurer, who lends at high rates to the improvident or necessitous, is a familiar figure. The peasant of Hindustan lives upon a very narrow margin. His crops barely suffice to feed his family until the next season's crops are ready, and at the end of a poor season he must either borrow or starve. Not only is he often necessitous; he is often improvident. At the marriage of a daughter or at a funeral, he will squander sums quite out of proportion to his means, and will borrow on any terms to raise the money,—a heedlessness of the future incomprehensible

[1] Compare what was said in Book II, Chapter 10, § 8, on "fair prices."

to the calculating Western observer. The usurer has him in his clutches. So, also, it was in old days with the fellaheen in Egypt. One of the boons which the English administration in Egypt has brought the nations is the establishment of a semi-public bank which has undertaken to displace usury by offering loans at competitive rates. In many parts of Europe, in Austria, in Ireland, in Russia, the lender of small sums to agricultural producers is a usurer; that is, he is removed from the influence of competition, he lends to poor and ignorant persons, and he exploits the possibilities of the case.

In medieval times the acceptance of interest by lenders was prohibited, at least for Christians (the prohibition was by church law, and applied to Christians only; hence the position of the Jews as money lenders). To receive from the borrower more than had been lent him was thought unrighteous. The explanation of this attitude, so different from the present-day acceptance of interest as a matter of course, is probably in the main that during the Middle Ages borrowing was chiefly for consumption. When the borrower uses loans for his own gainful operations, the bargain between him and the lender as to interest seems natural and equitable. But where he is in need, and uses the loan to satisfy pressing wants, the lender's requirement of interest has an aspect of harshness. Moreover, in medieval times competition and market rates of interest hardly existed. Such loans as were contracted were often on terms fixed by the necessities of the individual borrower. As the division of labor and the use of money spread, as industry became more complex and the instruments of production more mobile, loans for production became common; and with this change came a change in men's point of view regarding interest. The exceptions to the original strict rule of the canon law, the excuses and explanations for departing from it, the nominal retention of the prohibition with growing practical relaxation, the final acceptance of interest on loans as a familiar and normal phenomenon, — all this illustrates the process by which men slowly adjust their prepossessions to new ways and new institutions.

§ 2. One form of loans for consumption remains of great quantitative importance in modern times, — public borrowing for wars. The drain on savings for this purpose has been enormous. Every great struggle has caused hundreds of millions, even thousands of millions, to be borrowed and squandered, — squandered, that is, so far as concerns the economic consequences.

The conditions of demand for this sort of use are highly inelastic. When a nation's blood is up, the means for prosecuting a war are demanded at any price. Hence a great war often causes a rise in the rate of interest which endures for years, perhaps for a generation. The Napoleonic wars, especially because of the huge loans contracted by Great Britain to carry them on, affected the current rate of interest through the first quarter of the nineteenth century. In the second half of that century there was a succession of wars and of consequent borrowings, — the Crimean War of 1854–1855, that of France and Italy against Austria in 1859, the American Civil War of 1861–1865, that of Prussia and Italy against Austria in 1866, of France and Germany in 1870–1871, of Russia and Turkey in 1876–1878. Each caused public loans to be contracted at home and abroad, and each had its effect on the investment market in the world at large. The whole series tended to bolster up the rate of interest over a long period. No doubt, the high rate served in part to bring out savings that otherwise would not have been made. In so far, the loans cannot be said to have withdrawn savings from productive use. They simply made possible larger investments by individuals, and an addition, virtually in perpetuity, to the money "capital" and the permanent income of the leisure class, — an addition not balanced, as is that of social capital, by a gain in the productiveness of labor. But in large part they turned to waste and destruction sums that otherwise would have been used in the peaceful work of industry.

§ 3. Another form of savings used in investment stands midway between those for production in the stricter sense, and

those for consumption. This is investment in durable goods suited for immediate use, of which dwelling houses let for hire are the most important type.

The hiring of a dwelling brings about an exchange of present means for future means, and the emergence of a premium, in essentially the same way as in the simplest loan at interest. The tenant normally pays as rental a sum sufficient to reimburse the owner or landlord for repairs, depreciation, and such charges as insurance and taxes; and he pays him in addition a sum which constitutes a net income to the landlord, and which is the interest on his investment. (We leave out of consideration for the present the land on which the dwelling stands; its relation to the gross rental will be considered in the next following chapters.) The landlord at the outset has present means or savings at his disposal, — the sum which he applies to building the house. If the rental which he receives were just enough to bring him back this same sum, covering the eventual return of his capital (as well as repairs and other current charges), he would get from the tenant or series of tenants precisely what he gave. But this return is spread, by installments, over a long time. We may suppose the house, for example, to last fifty years, being worn out and useless at the end of that time. The full repayment of the capital sum will then be completed only after the lapse of half a century. A postponement of satisfactions on the landlord's part is necessarily involved, and will not be accepted unless there is some inducement, — unless the tenant pays *more* than enough to repay the sum originally invested; that is, unless interest is paid.

Where a building, or indeed any other concrete form of wealth, is expected to last a very long time, depreciation (that is, the gradual recovery of the capital sum invested) plays but a small part, and the rental, over and above repairs and expenses, is made up almost solely of the interest charge. Strictly, the investor should always face the fact of depreciation. Though some forms of durable consumer's wealth, like a few

forms of producer's wealth, seem to endure indefinitely, decay and depreciation eventually set in. In many cases of such investments, however, it is probable that the distant future when the capital sum will finally have to be replaced, is forgotten. The landlord, in his calculations of rentals, will often reckon merely on interest; with allowance for repairs and other expenses, but without allowance for the ultimate replacing of the initial investment. In regions where population is growing, this sort of real or apparent miscalculation is fostered by the expectation that a rise in the value of the land will offset the depreciation of the building, — a phase of the subject which is reserved for later consideration.

Turning now from the conditions of supply to those of demand, we find a situation less complex than that as to the demand for producer's capital. The demand for house room and the like is similar to that for other present satisfactions. House room is constantly compared with other utilities, and exhibits the same gradations of demand. The dwelling yields shelter, and it may satisfy the love of beauty. It ministers in no small degree, also, to the love of distinction; for here is one of the most familiar forms of display. The more of these gratifications are offered, the lower will be their marginal utility and their price. Suppose that dwellings were the only available form of investment, and that all the sums saved were turned into this channel; we may reason that, as a steadily increasing supply of such sources of satisfaction was offered, the amounts which purchasers would pay for successive installments of them would grow less. Still supposing them to be the only form of investment, we may reason further that the decline in rentals would not cease until investors (those building dwellings for hire) came to the conclusion that it was no longer worth while to abstain from the present use of their means in the process of providing house room for tenants; or, to speak more carefully, when the last or marginal investor came to this conclusion. The case would again be one of the equilibrium of supply and demand.

Other forms of consumer's wealth present the same phenomenon. Pianos, the furniture in lodgings, theatrical costumes and fancy dress, carriages for hire, — all illustrate the principle. In these, wear and tear, and allowance for depreciation, play a larger part than in dwellings, and interest forms a smaller proportion of the gross rental. The civilized man's repugnance to miscellaneous and indiscriminate use of his possessions sets limits to the spread of such hiring and letting; but anything which by custom can be passed readily from one person to another, like a dwelling or a piano, may cause a return to arise in the way of an interest payment.

Consumer's wealth of a durable and transferable kind thus offers still another way of investing present means and of securing an interest return. The whole mass of savings put aside for investment is to be compared with all the opportunities for utilizing them, — in production, in loans for consumption, in consumer's capital. They combine to make up the total demand which is to be set against the supply of savings. No one of the various opportunities can be said to dominate the others, so far as the rate of interest is concerned. But they are by no means of equal quantitative importance. Except for public borrowings, loans of the spendthrift type are comparatively small in modern communities. Durable forms of consumer's wealth, of which dwellings are typical, present a much ampler and steadier opportunity for the investment of savings; one which enlarges *pari passu* with an increase in population and in general prosperity. The operations of production, and the possibility of increasing the efficiency of labor by applying it elaborately over time, form the most important opening of all. In this sense, loans for production may be said to dominate the market and to settle the return to all kinds of capital and investment.

§ 4. We are now prepared to give an answer to a set of questions suggested at an earlier stage, which have to do with the relation of producer's wealth to consumer's wealth, and the definition of capital.[1] Matters of definition, though not in

[1] See Book I, Chapter 5, § 3.

themselves of the first importance, yet repay discussion, because they compel reflection on the essentials of the things defined.

Producer's wealth and consumer's wealth are similar, in that they are both instruments. Both serve to provide utilities or gratifications. They differ as to the time at which the utilities will emerge. Producer's wealth brings no utilities in the present; all of its effects are to appear in the future. Consumer's wealth brings utilities in the present. But not all of its utilities are so brought. It sheds them, so to speak, continuously throughout its existence. The longer it lasts, the longer will the process continue. Some of its utilities are thus also future; and the more, in proportion as it is durable.

The most general statement of the conditions under which interest arises is that it results from an exchange of present things for things future. This proposition, more or less foreshadowed in the discussions of a long series of economists, and in our own time sharply formulated by the brilliant Austrian economist, Böhm-Bawerk, applies to all the various operations in which a surplus appears for him who makes loans or advances. It applies no less to operations which involve consumer's wealth than to those which involve producer's wealth. From this point of view, the one is capital as much as the other. In both cases true interest arises; due to the fact that the present ordinarily outweighs the future in attractiveness, and that those who have present means at command will not postpone enjoyment of them unless some inducement in the shape of premium is offered. So far as the problems of distribution are concerned, consumer's wealth and producer's wealth thus present similar phenomena. Either of them may fetch interest, and so lead to the emergence of a leisure class, — a set of persons who have an income from accumulated means and who need not work for their living.

Though thus similar in the essential relations of present to future, the two forms of wealth yet present differences in other respects. There is an obvious difference in the nature of the social advantage secured from the possession of present means.

That advantage, in the case of producer's wealth, is found in the increase in the productiveness of labor because it is applied in the "capitalistic" way. The demand for producer's capital and the ability of the users of capital to pay interest depend on factors which do not bear on consumer's capital or on interest derived from consumer's capital. The progress of invention, the growing effectiveness of larger plant and more costly tools, the possible limits to the increase in output from more laborious preparation, — all these are questions which must be considered with reference to capital in the narrower sense, and do not present themselves as to consumer's wealth.

§ 5. When once the payment of interest is a familiar and accepted fact, it is extended to all cases where present means are in one person's hand and are turned over to another person. He who has money to lend can always get interest on it. He who borrows must pay for the veriest fraction advanced to him and for every day of the advance. The competition and interaction of a highly developed banking and credit system is always keeping the possessor of present means in connection with those who are the eventual users of capital and the ultimate employers of labor; and interest can be continuously and unfailingly secured on every scrap of disposable cash.

Here, as in so many fields of economic activity, the persons directly engaged are little aware of the significance of their doings. The professional money lender knows by everyday experience that he can always get interest on the money he has to lend, and he commonly thinks of it as "earning" interest. He who borrows accepts the need of paying interest as a necessary part of the world as it is, and does not stop to think that his own demand for present means — in order, say, to buy a machine or a batch of materials or wares — is part of the very situation that causes a return to the lender to arise. Just as under the division of labor, each individual worker has no consciousness of the part he plays in the complex organization of industry; just as, in the adjustment of foreign trade, each merchant has no notion of his place in the mechanism, — so

neither individual lenders nor individual borrowers have insight into the conditions which underlie their bargainings. Economists are often twitted with being theoretical and out of touch with the facts of industry. Much more unpractical is the attitude of the average business man, who is familiar with but one small corner of the industrial world, contents himself with the most superficial commonplaces, and knows so little of the larger problems of economics that he is hardly aware even of their existence.

§ 6. The minimum rate of interest, on the best security, differs a little between different countries. It is lowest, and has for generations been so, in England. It is sensibly higher in France. Until the close of the nineteenth century, it was higher in the United States than in most European countries; but of late it has gone down in this country, and has tended to be nearly as low as in England, and quite as low as in France or Germany. As a rule, it is higher in new, prosperous, and rapidly growing countries; lower in old countries that have long been prosperous. The explanation is mainly to be found in the varying conditions of supply and demand, in the race between accumulation and improvements. In a country like England, which has enjoyed complete internal peace and high industrial prosperity for two centuries, accumulation has been steadily great, and, notwithstanding the periodic sweeping away of large amounts through loans for war expenditure, there has been almost constant pressure to find advantageous employment. France has enjoyed similar prosperity only since the close of the Napoleonic wars, and, though long a rich country, has never had such an overflowing supply as England. Moreover, her huge public debt (now roughly five thousand millions of dollars, with an annual interest charge of two hundred millions) has withdrawn from productive use a larger part of her people's savings. From both countries there has been an outflow of money means for several generations, through investments in countries where the demand for use in production has been great. Germany, whose industrial advance

since 1870 has been extraordinary, has also reached the stage of fast accumulating resources, and of overflow to other countries. From all these the outflow is chiefly to the newer countries, whose own accumulations are not yet great, whose resources are still not fully utilized, and whose opportunities for using capital are large and profitable. Such was the United States throughout the nineteenth century, and such, notwithstanding the amazing increase of its wealth and savings, the United States in some degree still is. Canada, Australia, South Africa, Argentina, Chili, and other regions have offered advantageous fields for investments from older countries. Not the least striking transfer of accumulations has been that from the older part of the United States, along the North Atlantic coast, to the West and latterly to the South of the country. From New England a steady stream of savings has flowed to the West, and has enabled the latter section to provide itself with much-needed capital.

If the transfer of savings from one country to another took place without question or hesitancy, the rate of return on investments would be the same in both. But it does not so take place. A loan to a person at home, or for use in an enterprise at home, is made more readily than one to a strange country; and something extra must be paid by the borrower who has to deal with a lender on the other side of a political boundary. Even where no political boundary has to be crossed, but only a less familiar region entered, the same sort of inducement must usually be offered; as when an Englishman is asked to lend in Canada or Australia, or a New Englander in Texas or Oregon. If the only supply in new and rapidly growing regions were that from their own savers, the rate of return there would be considerably higher than in fact it is. The inflow from older countries brings it down, though not to a rate as low as that prevailing in those older countries.

The same sort of difference arises between familiar and unfamiliar investments within the same country and region. A large city like Boston and New York can borrow on better

terms than a small town or municipality, even though the latter be as near and as solvent. A large railway corporation, whose securities are known favorably to a wide circle of investors, can sell its bonds (that is, contract its loans) more advantageously than a modest enterprise, even though the latter be no less secure. The activity of bankers and traders and the publicity given by stock exchanges tend to lessen differences of this kind, as they do those between countries; but some differences still persist.

In all this process of transfer, and tendency to equality without the attainment of complete equality, account must be taken of risk. Investments in a raw country, promising as they may be, and likely to yield in the end returns larger than in old countries, often contain elements of uncertainty in each individual case. Hence something in the nature of an insurance premium must be paid.

Unattractiveness tends to keep high the returns from some forms of lending. Pawnbrokers' loans at best are made, as has already been remarked, under circumstances which prevent the full effect of competition from being felt But even if made at rates resulting from complete knowledge of market possibilities by borrowers, they would doubtless be higher than ordinary loans; since such lendings are not in social esteem. Similarly, dwellings and tenements let to the poor commonly yield a return higher than the current rate, even after allowing for the risks of nonpayment and the considerable expenses of management and collection. There is an aversion to dealings that involve real or seeming pressure on the necessitous. Though "philanthropy at four per cent" has caused model dwellings in cities to be offered to the poor at rentals that yield the owners no more — possibly a shade less — than could be secured in other ways, such operations have reached but a small part of the field, and it still remains true that investments of this kind ordinarily secure a return above the current rate. For reasons of the same kind, business premises used in American cities for the retail sale of liquor

secure an unusual return: a certain discredit attaches to this sort of investment.

§ 7. What can be said, in conclusion, of the justification and social significance of interest?

In the older English books on economics, interest was often said to be the "reward of abstinence." The phrase has often been ridiculed: a Rothschild or a Vanderbilt abstains and deserves a reward! The clear-headed among the older economists probably never had in mind a moral connotation in the phrase, though those who tried to popularize their theories often did. It simply tried to state a fact: that interest arises because the accumulation of savings and the making of capital involve "abstinence." The person who has the present means for saving and investment may have got them by swindling or robbery; or he may have got them by the exercise of productive faculties in ways advantageous to his fellowmen. The act of saving from such means, again, may be of a kind deemed meritorious, as, for example, if it is to provide for wife and children; or it may be an idle heaping up from superfluous income, animated only by senseless rivalry in money making. It is all one, so far as concerns the strictly economic theorem. The essence of this is that present possession is preferred to future, and that present resources will not be exchanged for future resources unless some inducement be offered. Here is a cold-blooded fact; whether it squares with moral desert is quite a different matter.

Interest seems to be an inevitable outcome of the system of private property and free exchange. It appears in early and simple societies, and grows in volume and importance with the greater complication and efficiency of the processes of production. At the outset it arises chiefly in the simple form of loans for consumption. With the development of our modern communities, loans for production have come to play a greater and greater part, until now they are the dominating form. As we survey the tangled course of economic history, it is impossible to see how the private accumulation of capital under

the stimulus of interest could have been dispensed with. In so far, it may be adjudged to be just.

But on other than this utilitarian ground, there is a case against interest, resting on the fact of inequality. Those who have saved and put aside present means usually have had ample means. Saving may have been a sacrifice, in the sense that postponement of present enjoyment is commonly irksome; but it has not commonly been an onerous sacrifice. Until within recent times, accumulation and investment were possible only for a very small circle of persons, who, by fair means or foul, had got an income much above that of the rest. The beginnings of modern capitalism are not known with any certainty, but it is clear that in its earliest stages and for many centuries only a small knot of traders, bankers, city folk of unusual prosperity, had any part in accumulation and investment. Though this situation is somewhat modified for our own day, by savings banks, life insurance companies, coöperative societies, and all the multiplied openings for investment by the masses, it remains true that most saving is done by the well-to-do and the rich. There is no statistical evidence to prove this with certainty, but such evidence is not necessary. Observation of the familiar facts makes it plain that accumulation and investment are now matters of steady concern chiefly for the small circle of persons who are already members of the possessing classes or in close association with them.

Interest-yielding property, thus the outcome of inequality, itself promotes and maintains inequality. Not only are those who receive it put in possession of greater present means, but, what is more important, they are enabled to perpetuate their own and their children's favored position as earners of income. The social stratification of our time, the separation of the well-to-do classes from the nonpossessing, is supported and strengthened by the income from existing possessions. The leisure class has emerged as the consequence of interest, and tends to perpetuate itself and enlarge itself through the receipt of interest.

To repeat, then, interest is an inevitable outcome of private property. The whole course of modern industrial development has taken place under the system of property. We cannot perceive that it could have taken place otherwise. The phenomenon of the leisure class has never been a *self-justifying* one for the unbiassed observer. It must be accepted as part of a system beneficial on the whole, and at all events indispensable; indispensable, that is, in the past and for the visible future. Whether private property and all that hangs thereby will last into the indefinite future, raises questions which are much wider than those directly connected with interest, and must be reserved for discussion at a later stage.[1]

[1] Compare what is said below, Book VI, in Chapter 54, on Inequality and Its Causes, and Book VII, Chapters 64 and 65, on Socialism.

CHAPTER 41

Overproduction and Overinvestment

§ 1. The present chapter is in part a digression. The subject of overproduction runs across more than one part of economic theory. It is connected with problems of production and of value as well as with those of distribution. The usual reasoning about it touches more especially on the possibility of overinvestment, and so on the determination of the return to capital. Hence it is conveniently taken up at this point.

"Overproduction" may mean various things, and the question whether there can be overproduction is accordingly to be answered in various ways. Let us consider first the widest use of the term: general overproduction beyond what men can use. Is such a thing possible?

The negative answer commonly given by economists rests on the extensibility of human wants. It is true that the bare physical needs of man for food, clothing, and shelter, are satisfied with comparatively little. If, with a possibility of further supplies, only more of plain food, simple clothing, dry shelter were added, there would soon be an excess beyond men's wants. But by varying the supplies, satisfaction can be added almost indefinitely. Refine the food, elaborate and vary the clothes and the house, and there seems to be no limit to what can be enjoyed. As Adam Smith remarked, "the desire for food is limited in every man by the narrow capacity of the human stomach; but the desire of the conveniences and ornaments of building, dress, equipage, and household furniture, seems to have no limit or certain boundary."[1] Nothing is

[1] Wealth of Nations, Book I, Chapter 11, Part II; Vol. I, p. 165 of Cannan's edition.

more extraordinary than the ease with which a man who begins with a small income and modest enjoyments, accommodates himself to larger means, finds new openings for expenditure which soon crystallize into "needs," and complains of a "high cost of living" which merely reflects his own habituation to growing comfort and luxury. All this is the result of variety, — through the stimulation of new wants and the discovery of new ways of satisfying them. The great increase of productive power during the last century or two has meant necessarily a diversification of industry and a constant resort to new things or new refinements of things familiar. Many articles which were formerly luxuries are now everyday comforts; and many which were formerly comforts are now deemed necessaries.

It is true that one of the wants to whose satisfaction additional means are turned is the mere love of distinction. Many things are valued, partly or wholly, for the simple reason that they are symbols of supposedly higher social station, — stiff linen, evening dress, horses and carriages, lavish entertainment, yachts, palaces. The expenditure for these is perhaps waste: waste, that is, in the sense that the satisfaction from them is elusive. On the other hand, this very satisfaction, resting on the instinct of emulation and ostentation, is one of the most universal in mankind, and has been a powerful stimulant to productive activity. So far as the problem of overproduction is concerned, it matters not how great or enduring is the enjoyment secured, how far proportionate to the expenditure involved. It suffices that as in fact men are, their wants of all kinds — for physical comfort, for æsthetic and intellectual gratification, for variety and amusement, for ostentation and display — are indefinitely extensible, and that there is no danger of producing more than they will at least think they want.

§ 2. It is not in this general sense, however, that "overproduction" is commonly spoken of. Trouble arises, it is contended, not from the production of more things than can be used, but from the production of more things than can be *sold*

at a profit. The trouble, it is said, is one peculiar to our modern capitalistic society, which finds itself in difficulties because of its very achievements. More is produced than can be disposed of to the capitalists' advantage, and loss ensues from the very operations which were designed to bring profit.

This, of course, is possible for any one industry and any one commodity. It is entirely conceivable that more bicycles or more silks should be produced than could be sold at a profit. The case, though not the usual one, occurs frequently enough to be entirely familiar. Mistakes and miscalculations will occur. But the remedy seems simple and automatic. If more is produced of any one thing than can be sold on profitable terms, the production of that thing will be diminished. Sooner or later — perhaps after a considerable interval, if the operations involve large plant — some of the producers will withdraw, supply will lessen, price will rise, and the overproduction will cease.

But, it is maintained, this avenue of escape is not available if all industries are pressing masses of goods on the market at the same time. If indeed a few industries only are producing beyond the point of profitable sale, labor and capital can be and will be transferred to others not thus embarrassed. But if those others are in the same quandary, there is no such remedy. And the tendency, it is said, is for all industries to be, if not permanently, at least recurrently and periodically, in the stage of production beyond the point of profit. Modern plant and machinery pours forth consumable commodities in huge quantities. True, while the machinery is in the process of making, there is demand for iron, timber, and other things used in making plant, and there is profit in producing them; and while the machinery is in the first stages of being used, there is demand for materials like coal, wool, cotton, and the like, and profit again in producing these. But when the consumable article — clothing, say — is finally put on the market in vast quantities, it cannot be sold on profitable terms. There is overproduction, stoppage, and shut-down, reaction in turn

on the making of plant and materials, cessation in the industries which produce these, and general depression. The recurrence of commercial crises is thus ascribed, in part at least, to recurrent overproduction.

In all this reasoning there is confusion of two essentially different things: on the one hand, investment beyond the point where a return to capital can be maintained; on the other hand, production beyond the point where a market for goods can be found. The first of these is quite conceivable, though highly improbable. The second, so long as human wants remain extensible, is not conceivable.

Let it be supposed, by way of putting the problem in its extreme form (and it is in this way that a question of principle is best tested) that accumulation and investment go on by leaps and bounds; that plant and machinery are indefinitely multiplied, and that consumable commodities are multiplied in proportion. What course of events will ensue?

First, purchasing power or "money" (to put it briefly) is turned to the buying of plant and machinery, and of materials for making these. It is no longer turned to the things formerly enjoyed by those who have become investors. There is a cessation, or great slackening, of "luxurious expenditure." With this change in demand, there ensues a corresponding change in the direction of production. The machine-making industries will be profitable, and the luxury-making industries unprofitable. Labor will be turned from the one to the other. The fallacy of supposing that labor will be less employed because of a diminution of luxurious expenditure has been exploded over and over again.[1] Saving and investment simply mean the employment of labor in a different way.

Before long, however, the plant and machinery must be used; that is, turned to making more consumable things. What sorts of consumable things will be in demand? Not such as are adapted to the demands of investors and savers (presumably, the well-to-do). These, by supposition, no longer buy for

[1] Compare Chapter 51, § 2.

enjoyment; at all events they reduce such expenditure to the minimum. The laborers, however, have passed no self-denying ordinance. For commodities adapted to their needs there is an unlimited market. To be sure, in order to induce purchase, things must be of the sort they fancy. But there is no difficulty in disposing of goods of this sort, offered cheap enough. Until the mass of mankind come to be in vastly more prosperous condition than has been dreamed of in all the utopias, an indefinitely extensible market can be found for goods adapted to their use.

But, to repeat, the things sold to laborers, as the quantity of them increases, must be offered at a lower price. If the whole process of enormous saving and appropriately modified production be carried on relentlessly, in the end all the goods for laborers' use will be sold at a loss. There will be universal overproduction of the kind which those maintaining the possibility have in mind, — production not indeed beyond the possibility of sale, but beyond the possibility of sale at a profit.

The real cause of difficulty, however, is evidently, not overproduction, but overaccumulation and overinvestment. More things are being advanced to the laborers than they reproduce. The essence of the process of capitalistic investment is that advances are constantly being made to laborers, and that the laborers are constantly producing more than has been turned over to them. The supposed increase of savings and the decline in luxurious expenditure bring it about that greater amounts are being paid to laborers than before. To put it in another way: before the process begins, part of the laborers are engaged in making commodities for the capitalists' consumption, and part for the consumption of the laborers themselves. After the process is completed, all the laborers (or virtually all) are engaged in making goods for each other, and none (or only a few) are engaged in making goods for capitalists. Then the laborers will be consuming more than they reproduce, and no return to capital can emerge.

The very statement of this result, and of the steps by which

it is reached, shows how improbable it is. The thing is conceivable, but so improbable that it may be declared virtually impossible. It assumes that saving and investing go on blindly, and quite irrespective of any return. Now, as has been pointed out in the preceding chapters, the connection between accumulation and interest is not a simple one. But it is absurd to suppose that accumulation would continue unabated if it resulted in no return at all. The very sort of pressure which is supposed to bring about this universal disappearance of profit, would bring quasi-automatically its own relief. As interest fell, more and more of the well-to-do would conclude they might as well spend as invest; would buy houses, pictures, automobiles, champagne, and would cause labor to turn to making such things. A balance would in due time be restored, by the making of less goods for laborers' consumption and by the return of profit and interest in all branches of production.

The extent to which the process of continuing investment could be carried, and the nearness of the eventual cessation of return, would depend on the effect of increasing capital on the productiveness of industry. As was noted in the preceding chapters, some economists believe that increase of capital means increase of production without limit; with an unfailing increase in the output, though at a diminishing rate. If this be the case, a return on capital will always be secured, however great the rush of accumulation. I have intimated my own view that the gain in efficiency from the application of more savings and the making of more capital, is not automatic or certain, but depends on the progress of invention. However that may be, it is agreed on all hands that a great pressure of capital seeking employment will lessen the return; and a progressive lessening of the return, or decline in interest, will bring *pro tanto* the same effect as disappearance of the return; it will check accumulation and so bring its own remedy.

Rodbertus, one of the ablest of the socialists, tried to explain crises by a theory of overproduction very similar to that just considered: a theory which made crises an inevitable adjunct

of private ownership of capital. His explanation has been repeated by Marx, and by other socialists. The well-to-do, it is alleged, are set on investing and on increasing production; they are not disposed to spend. The laborers, on the other hand, have not the wherewithal for spending. Hence producing power tends constantly to outrun consuming power; hence the recurrence of crises. The answer is that the laborers *are* quite able to spend. The process of investment by the well-to-do simply means that the "consuming power" is turned over to the laborers. There is no lack of consuming power. If, indeed, this process goes to its limit, if the investors persist in saving willy-nilly, the ultimate result must be overproduction in the sense of disappearance of profit or interest. But this limit will never be reached. Long before it is approached, an end will come of the excessive investment; demand will be readjusted, and the various sorts of goods will be turned out in such apportionment that (barring the inevitable occasional mistakes) all will be sold at a profit.

This analysis of extreme cases and impossible hypotheses, fanciful though it may seem, is necessary in order to bring into sharp relief what is really meant by overproduction of the kind supposed. And it has more bearing on the actual phenomena of modern life than it appears at first sight to have; because, though the extreme case is not reached, tendencies do exist which suggest it. To these attention may now be given.

§ 3. Accumulation in modern times does proceed, for short periods, blindly and almost automatically. Savings are made and are invested, merely because the habit of doing so has become ingrained among the possessing classes and because the mechanism for the first steps in investment has been so perfected, — public and private savings banks, investment bankers, stock companies, and the like. Hence, for familiar and approved sorts of undertakings, there is always available "capital" (in terms of money) without limit. And there is a great and nearly constant pressure of competition in these undertakings, and a tendency toward "overproduction," —

that is, toward putting on the market more goods than can be sold at a profit. This tendency is not peculiar to industries which produce commodities for laborers' consumption. It appears in any well-established industry, or rather in any industry conducting its operations in a well-established way. Here competition is ever active. The return to capital is within a hand-breadth of the minimum; there is constant danger of something like "overproduction." And this, again, threatens industrial irregularity and uncertainty, — stoppage because of disappearing profit; resumption after a while in the hope of restored profit; unwillingness to abandon the investment entirely, yet inability to maintain it, or at least inability to enlarge it, at a profit.

The path of escape from this danger — if a real and general danger it can be considered — is obvious. It is by change, at once in the methods of production and in the direction of production. Change in the methods of production is constantly taking place in the established industries. So long as improvements involving more capital (that is, more application of preparatory labor in "roundabout" methods) are made, there is an opening for a return on a larger investment. Change in the direction of production takes place by variety, by finding new things to satisfy newly awakened wants. Ornaments, wall papers, rugs and carpets, tableware, household furniture, fruits, — there are hosts of such new things to which labor has been turned as competition has threatened overproduction in the staples which alone were familiar a few generations ago. It has sometimes been pessimistically said that all the inventions and machinery of civilization have not improved one whit the lot of the mass of mankind. Yet he who will observe what are the kinds of commodities now produced for the masses, and compare them with the slender list of things available even for the richest but a century ago, must see how mistaken is the statement. It is more nearly true that the toil of most men has become no less. Certain it is that there has been a vast gain in the abundance and variety of the goods which

yield utilities. The mode in which this gain has been secured without "overproduction," that is, without general selling at a loss, has been on the one hand by invention and improvement, on the other hand by diversification in the articles produced.

There is thus a show of reason for the statement that the capitalistic system of production bears in its bosom the seed of its own destruction. The constant pressure of accumulation does threaten to annihilate profit. But it has also the forces of recuperation,—invention and variety. And in the last resort there is always the option, sure to be exercised before a real breakdown occurs, of ceasing accumulation.

§ 4. Among individual industries, some seem to be more than others in danger of occasional, even of recurrent, overproduction; that is, of such large output that they must sell at a loss. Industries of a familiar kind, which use a very large plant, seem to be in this case; especially if they are subject to seasonal irregularities of demand.

Thus there has been constant talk, for the last thirty years, of "overproduction" of our American anthracite coal, and of the need of reducing its supply in order to avoid loss. Now like all mining, this involves a large investment in shafts, levels, machinery, transportation. In the case of anthracite, the plant must be sufficient to supply the heavy needs of the winter months; since the fuel is used chiefly for domestic purposes, the amount called for is much greater in that season. Coal used for power, as bituminous coal so largely is, suffers no such marked seasonal oscillations of demand. The plant for anthracite, which must be adequate in winter, is more than adequate in summer. There is a temptation, none the less, to utilize it continuously, summer and winter. As with all plant, there is a *prima facie* loss in leaving it idle. Storage on a great scale, which would equalize the irregularities of consumption, is extremely difficult. Hence, we are told, there is recurring overproduction, and some agreement must be reached among the producers by which the total amount put on the market shall be kept within the bounds of advantageous dis-

posal. Otherwise, there is feverish activity at one time, with cutthroat competition, followed by stoppage and depression; the whole round means irregularity in employment, and evil social conditions.

It is on such grounds as these that combinations have been said to bring real advantage to society.[1] It is not impossible that they will do so; but I suspect the danger is exaggerated, while the remedy may be worse than the disease. Business men and capitalists, when they speak of overproduction, commonly mean, not that profits have disappeared, but that profits are less than they wish. They talk of maintaining a "fair" profit, when they really wish to secure a fat profit. Overproduction, that is, supply so great as to bring about sales at an actual loss, is probably much less common than the business community would have us suppose; and when it occurs, it is due to oscillations in demand which would probably affect a combination or trust as much as a body of scattered producers. The advocacy of combination as a means of avoiding overproduction and industrial irregularity is commonly but an excuse for trying to build up a monopoly which will restrict production, and secure (or try to secure) regularity at the expense of extra levies on the public.

§ 5. Some of the phenomena connected with crises, and especially the course of events during a period of depression, have been ascribed to overproduction. During times of depression, it would seem, more is produced than can be readily sold or than can be sold at a profit: is there not general overproduction?

These phenomena, however, result from the breakdown of the machinery of exchange.[2] They are not due to permanent or deep-seated difficulties in finding an extensible or profitable market. They are due to the fact that confidence has been shaken, credit disturbed, the usual course of production and sale subjected to shock. They may, indeed, be ascribed in part

[1] Compare what is said below, Book VII, Chapter 63, § 5.
[2] See the chapter on Crises, Book III, Chapter 29.

to some real "overproduction," — to the fact that some industries have been pushed beyond the needs of the present, possibly beyond any needs, whether present or future. These things correct themselves in time. The mechanism of exchange is restored to its normal working, and the maladjustment in production is set right. Unfortunately, as we have seen, a state of completely normal adjustment is never reached. Undue activity is likely to succeed undue depression. But these oscillations are in essentials not connected with any tendency to general overproduction. The problems which they present relate largely to money, banking, credit; for a solution, they point to the improvement of intelligence, and the possibility of conducting industry with progress and yet without irregularity. They are little related to those supposed limitations of demand, and those possibilities of permanent overinvestment, which are urged by the persons who maintain that there is danger of general overproduction.

CHAPTER 42

Rent, Agriculture, Land Tenure

§ 1. To understand the reasoning of the present chapter, the reader should turn back to Book I, Chapter 13. There value under the conditions of differing cost and of diminishing returns was analyzed. Equilibrium of supply and demand is found under these conditions when marginal cost and marginal utility are equal. Stated in simpler terms, the cost of the most expensive portion of the supply regulates the long-run value of the whole supply.

It follows that those who produce at lower cost secure more than ordinary gains. Referring once more to the diagram (vol. I, p. 180), it will be seen that the marginal producer at B, who sells at the price BP', secures the ordinary gains on capital and the ordinary remuneration for labor, — whether his own capital and labor, or labor and capital which he hires at interest and for wages. If he did not secure such gains, he would sooner or later withdraw from the industry. The producer at A has smaller expenses of production, measured by the distance AA', and it would be perfectly possible for him to continue operations at the price AA'. The producer at O, who has the greatest advantage of all, could continue operations if the price were as low as SO Both sell, none the less, at the ruling price $BP' = PO$, — the price which must be paid in order to make it worth while for the producer at B to keep on, and which must be paid in order to bring about equilibrium. The difference between the larger sum BP' and the smaller sums AA' and SO measures an extra gain for the more advantageous infra-marginal producers. The total gain to all these fortunate persons is indicated by the area, of approximately triangular shape, $PP'S$.

This additional amount, secured by those producers who have advantages over the marginal producer, is commonly called "rent" by writers on economics, because it usually arises in connection with land. It has been proposed to call it "producer's surplus." In ordinary parlance, rent signifies a sum paid by one person to another for the loan or lease of any durable thing, such as a tract of land, a house, a piano. Its use by English-speaking economists, to signify producer's surplus, with special reference to land, has gone on for several generations, and on the whole has served to affix to the word "rent" this technical sense. It is true that "producer's surplus" is more apt, and that the technical meaning of rent has the disadvantage of conflicting with everyday usage, and so of leading to misunderstanding among those not familiar with the terminology of the writers on economics. But "rent" has the advantage of brevity, and the sanction of long-continued usage by the best-known writers. It will be used in this book in the technical sense. Where there is danger of misunderstanding, it will be spoken of as "economic rent." Where the word "rent" is used in its popular, and not in its technical, sense, the context or express warning will guard against confusion.

Rent forms no part of the expenses of production; that is, it forms no part of those expenses of production which affect price. It is a differential gain, an excess over and above the total expenses of the more fortunate producers. Price is determined by the cost of the marginal increment. Rent is not one of the factors bearing on price, but is the result of price. It is due to the comparatively high price which must be paid to bring out the total supply.

It is true that there are conditions under which rent may seem to enter into the expenses of some producers. Suppose that the producer at the point *O*, possessed of a source of enduring advantage, — say a fertile or advantageously situated plot of land, — does not wish to carry on operations himself, but lets his land to some one else. That other person will be able to pay him for the use of the land an amount measured

by *SP*, or the total rent. Not only will he be able to do so, but he will be compelled to do so by competition. The amount *SO*, on that land, suffices to meet all the expenses of production, including remuneration to labor and adequate return to capital. If the owner offers it for use by tenants, they will bid against each other for the land up to the point where they will retain for themselves the usual return for labor and capital; that is, they will bid a rent up to the amount *SP*. Thereafter the tenant, having contracted to pay *SP* as rent, will say that his expenses of production are no less high than those of the marginal producer at *B*. Though he pays out less for labor and the like, he pays rent, which the marginal producer has not to pay. From his point of view, rent is as much an expense as wages, and his total expenses are no less than those of any other producer. But all payments of rent, though they are called expenses by such tenants, clearly stand in a different relation to price from the expenses at the margin of production. They are the consequence of lessened expenses within the margin, not the cause of price at the margin. They serve to equalize the position of different persons no one of whom is so fortunate as to own an advantageous source of supply. For the person who does own such an advantageous source, they form an extra gain, which is secured equally whether he exploits his advantage on his own account or receives a payment from another who bids for the privilege of using it.

The typical case of rent, and the one which serves most readily to illustrate the principle, is that of agricultural land. Suppose that the producers at *O*, *A*, and *B* have farms of different fertility. A given application of labor and capital yields at *O* 25 bushels of wheat to the acre, at *A* 20 bushels, and at *B* 15 bushels to the acre. The price must be such as to make wheat-raising at *B* worth while; otherwise the total supply will not be forthcoming. The supply which can be raised at *O* and *A* is limited and an additional supply must be got at *B* before an equilibrium of supply and demand is reached. The price is high enough to bring normal returns to

the producer at *B* for 15 bushels to the acre. The receipts from these 15 bushels also suffice to cover the expenses (including usual return to capital) for the producer at *A*. The extra 5 bushels got from his land thus constitute an extra gain for him. Similarly the extra ten bushels at *O* yield an extra gain for the producer at *O*. And if the owners of *A* or *O* chose to let their lands, instead of cultivating for themselves, they could secure rents of 5 and 10 bushels to the acre (or the equivalent in money price). It is immaterial whether they secure the advantage from the better site in the one form or the other.

Rent is sometimes said to be the specific product of land. Similarly, interest is often said to be the product of capital, and wages the product of labor; and thus three elements in distribution — wages, interest, rent — are set against three factors in production — labor, capital, land. But this phraseology is to be used with caution. The reasons for questioning it with regard to capital have been already stated.[1] Labor applied in some ways (through the use of tools) yields more than labor applied in other ways; in this sense only is there a productivity of capital. The same language should be applied to land. Labor on some land yields more than labor applied on other land; in this sense only is there a productivity of land. If land were unlimited in supply and all of uniform quality, the natural forces inherent in it would still be directed and utilized by labor; and in this sense there would be a productivity of land. But there would be no differential return on any one plot of land, no emergence of rent, no notion of a separate productivity of land leading to rent. Rent arises because of the limitation of the better sources of supply; because of differences in the amounts brought forth by equal quantities of labor.

§ 2. Such is the fundamental principle of rent. But it requires many qualifications. These concern the kinds and causes of difference in productive efficiency, and need separate

[1] See Chapter 38, § 3.

consideration. The case of agricultural land, which has been used most often to illustrate the principle, may be first taken up, and will engage our attention for the rest of the present chapter.

Unless there were a tendency to diminishing returns from any one plot of land, there would be no such thing as rent. If the better sources of supply could be pushed indefinitely without any lessening of yield, — if more and more labor and capital could be applied to a given plot of land, and could always bring an increase of product proportionate to the additional outlay, — then those better sources of supply only would be resorted to. The less good lands would be left untouched, and all agricultural produce would be got from the best lands. The fact that this is not the case; that good lands, mediocre lands, and poor lands are cultivated side by side, — proves that at some stage a tendency to diminishing returns appears.

When additional labor and capital are applied to cultivation, it may be a matter of indifference whether they be applied to poorer land, or to the better land under poorer conditions. In the preceding section, three grades of land were assumed, having yields, for the same application of labor and capital, of 25, 20, and 15 bushels to the acre. But it might also be supposed that the three applications of labor and capital were all made on the same land, yielding successively diminishing returns in the ratio of 25, 20, 15. In either case, the marginal product is 15. In either case, the 15 bushels constituting the last installment will not be brought to market unless the price is such as to make their production worth while; hence, in either case, the other installments bring a surplus or rent. In either case, the *margin of cultivation* is that stage in production where only the normal returns to labor and capital are secured. The margin is said to be extensive, when poorer land is resorted to; it is said to be intensive, when more capital and labor are applied under less favorable conditions to the better land. Difference in yield would appear, and hence

a differential return, even though all land were originally of the same quality. In fact, there is never such a thing as equality in the natural endowments of land. Some land is better than other, hence there is both an extensive and an intensive margin of cultivation.

Differences in situation have precisely the same effect as differences in fertility. An apt illustration of the effects of situation (first elaborated by the German economist, Thünen) is got by supposing all land to be of the same quality, and to be situated on all sides of a central city to which its produce is brought for sale. Imagine concentric circles to be drawn about such a central point. Evidently the land in the nearer rings has an advantage over that in the more distant rings. All the produce is sold in the central market at the same price; but that from the more distant land has to bear a higher cost of transportation, and its cultivator must be reimbursed for this. The owner of the nearer land has an advantage which causes rent to arise.

The advantage due to situation obviously is less, the lower the cost of transportation. The cheapening of carriage in modern times has greatly diminished the importance of situation rent. This is strikingly the case for all agricultural produce,—grain for example, which is easily transportable. Though refrigerating apparatus and fast freight facilities have made it possible to bring meat, fruit, vegetables, and milk from very distant sources of supply, the nearer lands still have some advantage from situation. If, indeed, the rates of transportation should be the same for all distances, the advantage would disappear. The railways which bring the milk to some of the large cities of the United States adopted at one time the practise of a "postage stamp rate,"—that is, an even charge on all shipments, distance being disregarded. So far as they carried out this method, advantages in situation, and consequently economic rent resulting from situation, were done away with for milk farms. As it happened, public authority was appealed to by the owners of the nearer lands to prevent

this practise, it being alleged that it was unreasonable and unjust to fix rates of transportation without regard to distance. The Interstate Commerce Commission sustained this contention, and forbade the postage stamp rate; though *prima facie* it would seem to have been to the advantage of milk consumers, and not in violation of any sacred or inalienable rights of the nearer producers.[1]

§ 3. We proceed now to some qualifications and explanations of the principle of diminishing returns.

In some stages of agriculture it may not appear at all. There are circumstances under which additional applications of labor and capital may yield for a time not less in proportion, but more. This is most likely to occur where a people advanced in civilization suddenly takes under cultivation virgin land, as has been the case during the last century in the United States and in other new countries. In the first or pioneer stage, cultivation for such a people often proceeds under difficulties. A second stage is reached, when more labor, more elaborate clearing and draining, more expensive agricultural implements, are put on the land; and then only is the largest return per unit of labor and capital attained. The question may be asked, how it happens — if this be the case — that additional lands are taken under cultivation at all before the stage of maximum productivity is reached on those previously resorted to. The answer is that the pioneer farmer looks not only to present yield, but to the coming years when, as owner of the soil, he will possess much land in good condition. It is the loadstone of complete ownership that attracts men to the breaking up of the wilderness. But the stage of increasing returns which the process of settlement thus involves is but a temporary one, — temporary, that is, in the industrial life of a community. Before many years, still another stage is reached: the time comes when the land, tilled in the more careful way of the post-pioneer stage, begins to cease responding to more

[1] Compare what is said below, Book VII, Chapter 60. On milk rates, see Interstate Commerce Commission Reports, Vol. VII, p. 92.

intensive use. Diminishing returns show themselves, and agriculture reaches what we may consider its normal condition.

Next, it is to be observed that the tendency to diminishing returns holds good only of a specific plot or specific plots of land. It does not necessarily follow that agricultural operations in general have to face this tendency. There may be additional plots of available land, no less good than those already used. The opening up of new regions has had far-reaching effects of this sort. It has greatly affected the older countries of Europe as well as the new countries themselves, and has given rise to the knotty problems, already considered,[1] as to the advantages of the trade between them. In the broad sweep of history, these are but temporary deviations from the permanent course of things; but for recent generations they have been of great consequence.

Finally, the tendency to diminishing returns must be understood with reference to a given stage in the agricultural arts. New and better ways of using the land may be discovered, and may make possible an increase of product in proportion to the increase of labor applied; nay, may make possible a gain more than in proportion to the additional labor. Thus, during many centuries, from the dawn of the Middle Ages until within a hundred years (more or less), it was customary in European countries that a part of the land — usually a third — should lie fallow each year, serving during that time only as a lean pasture for common use. The land actually under cultivation at any one time was only two thirds of the total; and any particular plot, after being in use for two years, was idle and recuperating for a third. About the middle of the eighteenth century root crops, especially clover, were found to offset in large part the exhaustion of the soil which results from continuous grain growing; and a systematic rotation of crops came into use, which enabled all the land to be kept under cultivation all the time, and yet (with judicious use of fertilizers) to maintain its productive power. After this

[1] See Book IV, Chapter 37, § 4.

great change, more labor was applied to each plot of land, than had been applied before; yet was applied under more favorable conditions. Again, during the last half century, the applications of chemistry to agriculture have shown the way to still better culture, — more elaborate rotation of crops, and the use of new fertilizers. The methods of plowing, draining, the selection of new varieties of plants and animals, have also been greatly advanced. Not least, agricultural machinery and tools have been greatly improved and cheapened. Hence the soil, when utilized in the best-known way, has been pushed more and more, with yet — up to a certain point — no diminution in the marginal return.

It seems paradoxical to say that there is a real tendency to diminishing returns, and also that in fact there have been increasing returns. Yet both statements are true. Though in backward countries, like British India and China, and even in some parts of Europe, the soil still is used in ways that we regard as primitive, — ways that prevailed five hundred years ago, — agricultural labor in the United States and in most parts of Europe is applied with much more intelligence and with better effect than five hundred years ago, or one hundred years ago. None the less there remains a tendency to diminishing returns. Improvements in the way of rotation, fertilizers, deeper plowing, systematic draining, stave off for a while the decline in return. So long as the amount which it is attempted to get out of any one plot remains moderate, the stage of pressure is not reached. But this moderate limit passed, any attempt to get an increase of product encounters serious and, before long, impassable obstacles.

So far as permanent differences in the yield from the different sites are concerned, it matters much whether agricultural improvements are equally applicable to all land, or are applicable only to some land. If, for example, they were applicable only to the poorer grades of land (or those deemed poorer in the earlier stages of the agricultural arts); if by some processes of drainage, clearing, and leveling, available

only for some soils once disadvantageous, these could be made as fertile as those previously more fertile, — then rent, so far as due to differences in fertility, would disappear, and would emerge only as all land came to be intensively used. But if the improvements in agriculture were equally applicable to all lands, the differences between them would remain. Good lands and bad would alike yield more, but there would still be an extra yield on the good lands; hence, so far as both were cultivated side by side, there would be inequality of return for the same labor, that is, rent. And this in general has been the effect of agricultural improvements. They do not obliterate the inherent differences. The only sort of improvement which has markedly unequal effects is the cheapening of transportation, which brings the more distant lands virtually nearer and greatly reduces advantage of situation

§ 4. With regard to any given plot of land, there is a stage, at which it may be said with substantial accuracy that the land yields all of which it is capable. It can then maintain virtually no more persons. It is only for the purpose of illustrating the general principle of diminishing returns that we suppose such an evenly ascending curve as that of the figure, vol. I., p. 180. Before long the stage is reached when a steeply ascending curve would represent the situation. The land can indeed be made to yield more, and the ascent would not become quite vertical. But the increase in cost for additional yield is prohibitory.

Though agricultural improvements counteract this tendency, and remove further the stage when the tendency to diminishing returns shows itself sharply, they seldom have great and rapid effects. When once a country's land is all taken up, and is brought under that kind of cultivation which the existing knowledge of agriculture has made familiar as the best, further advance of production takes place but slowly. Hence population can increase but slowly, so far as it depends for support on the country's own land. It is true that some economists and students of agriculture believe that with wide-

spread utilization of the best kinds of tillage, the yield of the land could be much increased even in thickly settled and highly cultivated European countries. I suspect that these possibilities are exaggerated. In any case, the rapid adoption of the best methods is checked, especially on the continent of Europe, by the ignorance and stolidity of great sections of the agricultural population. Hence, even though there be considerable possibilities of improvement, the stage where diminishing returns will begin to appear sharply is in fact not far ahead. If a marked increase of population in modern times has not caused a severe pressure to be felt, the explanation is found in that great change which has so profoundly influenced all recent economic history, — the extraordinary improvements in transportation and the opening of additional sources of supply in new countries.

§ 5. Ricardo, with whose name the theory of rent is most associated, remarked that rent "is paid . . . for the use of the original and indestructible powers of the soil." But it is urged that the soil has no indestructible powers. If continually cropped, it loses its powers. "Worn-out land" is a familiar phenomenon. The soil contains certain chemical constituents, which are taken from it by growing plants, and whose continued loss means the eventual destruction of fertility. The chief of them is nitrogen. This is restored (though by uncertain and irregular steps) through the spontaneous action of nature if the land be not cropped; hence the ancient practise of letting land lie fallow, or allowing it to "rest." But it is restored more promptly and effectively by fertilizers and by the rotation of crops, and especially by the root crops. On all these chemical processes the science of modern times has thrown a flood of light, explaining the practises which had been empirically worked out in former times and pointing the way to new and better practises. Certain it is that improvident cultivation wastes the powers of the soil, and that there is need of restoring to it what continuous cropping removes.

When new land is first taken in cultivation, the necessity of

restoration is not felt. The store of elements of fertility is then large, and may maintain itself, notwithstanding continuous drain, for years and even for a generation. If there be plenty of new land, another parcel can be taken under cultivation when signs of exhaustion appear on that first used; and so on, as long as new land is available. This is what the Germans call "*Raub-bau*," — predatory cultivation. Thus in Cuba, on the sugar lands, the crop is grown continuously year after year, the juice being extracted from the cane, and the stalks and leaves burned as fuel. There is no fertilizing, and not even those elements which are contained in the stalks and leaves are restored to the land. But after a series of years, even the richest sugar land begins to show a declining yield. Then, however, the planter turns to fresh plots, and the same process begins over again. It will continue until no more fresh land is available; for predatory cultivation, so long as the land holds out, is the most profitable.

Such has commonly been the first stage of agriculture in the United States, especially on the fertile lands of the Mississippi Valley and the West. The usual crop has been wheat, because of the universal demand for that staple and its easy transportation. In this pioneer stage, wheat is grown year after year, with no manuring or little of it, and often with burning of the straw. Where the soil is rich in humus, such use of it can be maintained for ten or fifteen years, and sometimes for an even longer period. Yet in time the signs of approaching exhaustion appear. The land no longer yields as before; it must have a "rest" or be "nursed"; and the farmer must either turn to plots of virgin soil, or cultivate the old with conservation of its capabilities. In the United States this transition has been often accompanied with a change in ownership. The pioneer sells his worn-out land — not yet in reality much worn out, but simply in need of more careful husbandry — to a newcomer, not infrequently a German or Scandinavian, who is habituated to more complex ways of cultivation; while the pioneer himself moves farther West, again takes up virgin soil, and repeats the old round.

Predatory cultivation is one phase of extensive cultivation; it stands in contrast with the intensive cultivation of England, France, Germany, and most parts of Europe. Extensive cultivation means that labor and capital are spread comparatively thin. The yield per acre is commonly small. Thus the average yield of wheat per acre in the United States is between 12 and 15 bushels. In England, the average is 25 bushels and more. But the yield per unit of labor and capital is smaller in England; for much more labor is applied to each acre. A farm of one hundred and sixty acres in the typical agricultural regions of the United States — say in the North Central states — is tilled by the owner and his family, with possibly one hired laborer. A farm of the same size in Great Britain is tilled by a capitalist farmer employing a whole staff of farm laborers.

Extensive cultivation, however, is not necessarily predatory cultivation. Labor and capital may be spread thin on the soil, yet nevertheless may be applied with care, and with due conservation of the elements of fertility. In the United States, the first stage of pioneer or predatory cultivation — lasting perhaps for ten or even twenty years — is usually succeeded by more careful, but still extensive, tillage. Most of the land in the upper Mississippi Valley is now in this second stage. It may be expected that, as population thickens and the resort to new land becomes more and more difficult, a gradual transition will take place toward the stage of high farming or intensive cultivation. More elaborate rotation of crops, more continuous use of each tract, deeper plowing, more frequent harrowing, systematic drainage, more abundant and more carefully selected fertilizers, will be used, as they now are in the advanced countries of Europe. This change is due to the tendency to diminishing returns, and is a sign that the conditions of pressure on the land have been reached. High farming is essential to maintain the productivity of the land if large returns are sought from it; but it means that those large returns are got with some difficulty, and

that the limit to the possibilities of increase is beginning to be approached.

In any case, as the land of a country is used more and more, its efficacy as an agent for production depends in greater and greater degree on what man has done for it. Those lands which were originally best have been denuded somewhat of their natural stores. Those which were originally less good have been brought nearer the average by continued careful cultivation. All have been leveled, drained, fenced, freed from large stones, and provided with roads. The differences between plots are thus less great, the longer they have been in use; and in old countries there is a tendency to bring all land to something like the same state.

From this it might be inferred that inherent differences in land cease to be of importance. But the conclusion by no means follows. It is true that all land needs careful use, and depends on man's action for the maintenance of its fertility; but all does not respond to man's action with the same ease or to the same degree. Land with a deep layer of humus contains very rich stores of latent plant food, not easily transferred to the plant, yet capable of being utilized almost indefinitely if only there be restorative cultivation. The physical constitution of land — in what proportions it contains sand, clay, humus — has an important influence on its possibilities for tillage. Though a sandy waste or barren hillside may be brought to a state of high yield by continued care and remaking, it cannot be brought to that state or maintained there with as little labor as land having better natural endowment. New England can never be made as fertile as Illinois and Kentucky. Climate, again, — sunshine, temperature, and precipitation, — is an important cause of enduring differences. The newly opened land in the Canadian Northwest, for example, of which so much has been said in recent years, seems to be well adapted for wheat growing, and promises for a long series of years to give profitable opportunities for pioneer cultivation. But when, after perhaps a generation, the inevitable stage of restorative cultivation is

reached, its possibilities will be found less than that of land in milder regions. Land that is frost bound through the larger part of the year is not a flexible instrument, and will not readily respond to more intensive cultivation. In the semi-arid regions of the Western states, — those stretches in Nebraska, Kansas, Texas, which lie intermediate between the well-watered Mississippi Valley and the arid plains of Wyoming, Colorado, and New Mexico, — it is said that "dry farming," in the way of deeper plowing, careful harrowing and rolling, specially selected seeds, will remove climatic obstacles long thought insuperable. Whether or no these expectations are fulfilled, it is certain that more labor will need to be applied in those regions than in the Mississippi Valley, where nature provides ample moisture.

Though inherent differences in fertility thus persist, it is true that on all land which has long been in use there is difficulty in determining how much the yield is affected by its "original and indestructible powers," how much by qualities supplied through man's action. Economic rent is extremely difficult to mark off. Beyond question it is present on some sites: thus on bottom lands in our Western valleys, where the layer of humus is extraordinarily deep; or (by virtue of situation) on convenient sites for market gardens close to great cities. We may be certain that on other lands there is little or none of it, —on the rocky pastures of New England or on the Highlands of Scotland. But on any particular plot which has been long under cultivation it is almost impossible to say how much labor is aided by the improvements made by man, how much by inherent properties.

When once permanent improvements have been embodied in the land, their effect is precisely the same as if nature had made the land good. Subsoil draining, for example, which has been applied during the last twenty years on a great scale in Ohio, Indiana, Illinois, and other states where the pioneer stage has been passed, means an irrevocable investment. When the drains are in, it is as if nature, not man, had provided the best

means of admitting moisture and of discharging the harmful excess. So it is when great operations for drainage are undertaken, — as on the Bedford Level in England, or the tracts on the Mississippi River along the boundary between Missouri and Arkansas. Extensive areas, high in the elements of fertility, have thus been freed from excessive moisture. Once these improvements are made, the retu -- the land depends on the principles of rent rather than on those of interest. It depends once for all on the productive quality of the land as it stands after the improvement.[1]

§ 6. The leasing of land and the payment of "rent" in the usual sense does not necessarily imply the existence of economic rent. What the tenant pays may be no more than the ordinary return, in the way of interest, on improvements made by the owner. But commonly the actual payment contains something of economic rent as well as of return on capital. Tenancy raises some independent questions.

Almost always tenancy is an obstacle to the best use of the land; for the tenant is concerned only with getting out of it what he can during his term, and is tempted to employ predatory methods. In its barest form, where the landlord does nothing, and the land is simply let to the tenant from year to year, it results not only in bad tillage, but in demoralized tillers. Such was the outcome of cottier holdings in Ireland, maintained there for centuries in the dealings between alien landlords and an oppressed and ignorant tenantry. The situation is better where there is fixed tenure in the form of long leases, with provision for compensation to tenants for improvements made by them and not exhausted on the expiration of the lease. Yet even under this arrangement the landlord must have a care for the way in which the soil is used, and he usually makes stipulations regarding the rotation of crops and the maintenance of improvements. Yet these very stipulations, if detailed, hamper the tenant unduly. In England, a practise of short leases (usually from year to year) has been carried on

[1] Compare what is said below, Chapter 43, § 4.

without much ill effect, because landlord and tenant have been virtually partners. The English farmer is a person of some means, who leases a considerable tract of land, and is prepared to cultivate it systematically for an extended period, relying on renewal of his lease at equitable terms so long as his husbandry is good. The landlord himself makes permanent improvements, and is thus an investor in the land. The actual payment made to the landlord represents economic rent only in part. Traditions of friendliness and fair-minded dealing between the two have made this arrangement a workable one; and indeed the agricultural arts in England have reached a high degree of advancement under them. In Scotland long leases, sometimes for twenty-one years, are common, and under them perhaps the most refined forms of intensive cultivation have been developed.

None the less, the most effective use of the land is likely to be made by the owner. Such, at all events, is the case where land is readily transferable, and so can be bid for and secured by those who know how best to make use of it. This facility is lacking in many European countries, especially in England and France; where, moreover, the obstacles which the state of the law presents are increased by the social prestige which often attaches to large landed estates and makes the owners reluctant to sell. In the United States, none of these obstacles exist. Here, at least in the northern part of the country, most land is tilled by the owners. Farms are constantly passing from one hand to another, according as varying possibilities of cultivation are perceived by different persons, — a condition which promotes the most productive utilization of the soil. In the North Central states, the great agricultural region of the country, about sixty per cent of the farms are tilled by their owners. During the last two decades, there has been some increase of tenancy in this region, and in the North generally. But the increase is largely due to the efforts of younger men to swing themselves into the position of owners, — a process which takes time in those sections where land com-

mands a high price, and where a considerable sum in hand is required to buy it outright. Notwithstanding the increase in tenancy, the conditions of land holding in the northern parts of the United States are satisfactory. The same is true of many parts of Germany, and especially of Prussia, where the percentage of land ownership is also high.

A not uncommon form of tenure in the southern part of Europe — in France and still more in Italy — is metayer tenure. The land is let for a share of the crop; often one half of the crop, but more or less according to the fertility of the soil and the extent of the landlord's other contribution. The landlord himself provides part of the capital used. Metayer tenure has the advantage of stimulating the cultivator to get from the land as much as possible; but evidently with the drawback which comes from the fact that the landlord also shares in the output. In the southern part of the United States there is a widespread practise of share tenancy among the negroes. The owners of the land here contribute a very large part (sometimes all) of the advances needed by the tenants: not only seed, implements, animals, but even the food of the negroes. This arrangement was doubtless inevitable under the conditions in which the Southern states found themselves at the close of the Civil War, the freedmen being destitute alike of means and of any experience in agricultural management. Yet it is not comparable in social advantage with complete ownership by those who work on the soil. It is inferior also to leases at a fixed money rent, where the leases are so adjusted as to bring security of tenure and encouragement to improvement. A wide diffusion of the ownership of land, and a predominance of cultivation by the owners, are the most wholesome agricultural conditions; and it is much to be wished that these conditions, which fortunately prevail over the greater part of the United States, should develop in the Southern states also.

§ 7. The considerations which have been adduced in the preceding sections — the need of conserving the fertility of

the land, the growing importance of man's action as cultivation becomes more intensive, the difficulty of distinguishing between nature's endowment and artificial improvements — have an important bearing on some social problems.

It has been proposed to confiscate economic rent for the benefit of the community. Rent is a surplus over and above what is necessary to induce investment; an unearned increment, tending to rise as growing population leads to greater demands on the soil. Why should the individual landowner keep it? Under the so-called "single tax," it is proposed that all land be taxed to the full amount of its economic rent; the tax being called single, because it is expected that so much revenue would be secured for the public as to enable all other levies to be dispensed with. Substantially the same result would be attained if the community were to take possession of the land once for all, never part with the title, and let the land to tenants for the amount of its rent, — allowing the tenant to keep for himself enough to pay for all his improvements and for interest on them, but requiring payment of the excess.

One fundamental obstacle in the way of this program of action is, as regards agricultural land, the difficulty of measuring the investment made in the soil and the normal return on it. Rent, as has been remarked, does not arise spontaneously. It is not earmarked as a separate return. Its emergence is inextricably intermixed with the complex processes of tilling the soil and of maintaining its fertility. For the effective use of the land, there must be elaborate application of labor, much experimenting, plans of cultivation that run over a long period; not least, constant individual watchfulness and care. No stimulus to the best use of land is comparable to that which comes from secure possession, from the certainty that he who makes it yield abundantly will reap the results of his industry. And no kind of secure possession is so effective to this end as untrammeled ownership. It is true that by private ownership the community loses something which, if discreetly carved

out, might be appropriated without discouraging good management; but the difficulties of discreet carving are so serious, and the need of good management so great, that the balance of social gain is against any scheme of taxation or periodic appropriation.

There is something attractive in the proposal that the community should never part with its title to the land, but should lease it only, — lease it, doubtless, for long terms, in such manner as to give tenants free scope for improvements and no inducement to impoverish the soil, and yet to bring back to the community in the end the gradually increasing increment of economic rent. If a country had started from the outset on this plan, and if its government were rigidly honest, highly intelligent, and excellently administered, this mode of managing its patrimony would be preferable to private ownership. But no country has started on this plan; or if it has done so (the historians are uncertain as to the extent to which the Germanic races began with a system of true communal ownership), long centuries of private ownership have followed. The spur of ownership was historically indispensable for the advance of the agricultural arts. It is conceivable that where a civilized community, equipped with the accumulated experience of centuries, takes possession of new land — as in the United States, Canada, Australia — it might retain in public ownership the fee of the land, parting only with long leaseholds. But it is precisely the fee which the pioneer generations covet. The thought of the conservation of the interests of coming generations rarely presents itself to them; or, if it does, they think of their own direct descendants only, not of the indiscriminate mass of the later population. Hence all communities, whether they have moved slowly through a long historical development or have begun at once on the plane of advanced civilization, have rested their industrial organization on private ownership of land. Land then has been bought and sold for centuries on the supposition that the property rights which have existed from time immemorial will

be maintained indefinitely into the future. To destroy all these acquired rights is not indeed unthinkable; but it would involve a reconstruction of the whole framework of society. It presents the problem of socialism, not that of the appropriation of the unearned increment.

A different proposal is that to appropriate, not the whole of the unearned increment, but the future accretions. Let vested rights — the private ownership of land and the enjoyment of existing rents — remain undisturbed. But take for society at large the increase of rents that will arise hereafter. There can be no objections in principle to this proposal. The sole question is whether it will on the whole bring gain to the community. To carve out economic rent proper, and to leave undisturbed those gains which are necessary to secure the effective use of the land, calls for high intelligence as well as scrupulous honesty among the public officials. A dull or corrupt administration of so delicate a function would work great harm and indeed would probably lead before long to the summary abandonment of the whole scheme. It is to be borne in mind, moreover, that where the ownership of land is much diffused, a wide dispersion of economic rent takes place, and those extreme inequalities are avoided which are the most objectionable results of the régime of private property. All things considered, — administrative difficulties and the imperfections of government, as well as strictly economic factors, — the balance of gain is probably in favor of the untrammeled right of private ownership in agricultural land, and of such legislative changes only as facilitate its free transfer and its easy acquisition by those who will use it best.

CHAPTER 43

Urban Site Rent

§ 1. Urban rent resembles in essentials the rent of agricultural land. Like that, it results from the differential advantages of certain plots. The application of capital and labor on some sites yields greater returns than on others. So long as the possibilities of production on the better sites are limited, the owners are subject only to a restricted competition, and can retain the extra return for themselves; and this, irrespective of whether they utilize the sites themselves, or let them to others.

What is the cause and the extent of the differential advantage of urban land, can best be elucidated by a consideration of the various ways in which the land is used. Most characteristic, and simplest in its manifestations, is the case of sites used for retail trading. Wherever throngs of people habitually pass, retail operations can be conducted with most advantage. Enter a great shop in the heart of a city, and observe what goes on. The selling clerks are continuously busy; the turnover of capital is large and quick; the building and all its appliances are in constant effective use. Contrast the scene with the village shop, where the shopkeeper lolls about during the greater part of the day, waiting for a customer; or (if he be energetic) has ample time for attending to other things also. For each unit of labor and capital applied, the product is vastly greater on the city site. By "product," in the case of the shop, we mean the contribution to the community's income of utilities or satisfactions, — the completion of what is usually the last stage in the process of getting commodities into consumers' hands. In everyday speech,

the same thing is expressed by saying that in the one place much business can be done, and very little in the other.

The precise reasons why some sites are better than others for retail trading are sometimes simple, sometimes obscure. Most simple are accessibility and familiarity. The places where urban transportation lines converge are the most valuable for retail trade. From such centers the retail streets commonly radiate, those being most advantageous along which the largest number of persons move to and fro in their daily tasks. Anything which causes many persons to betake themselves to a given point — a railway station, a post office, a theater — gives the neighboring sites an advantage for retail trading. Less simple are the effects of tradition, or of proximity to the dwellings of the well-to-do, or of the initiative of a few skillful dealers, by which one street or region rather than another may come into vogue for shops of the more expensive kind, and its profitableness may for that reason become greater. Display has a great part in attracting customers (it is a cardinal maxim of the retailer that his windows must show his goods); hence the southern side of the street, where goods can be put into show windows with most effect and with least danger of spoiling, often has an advantage over the northern, and commands a higher rent.

The prices of the commodities sold on the expensive sites are not usually higher. Here, as in the case of agricultural land, rent is not a cause of high price. It is the result of the facilities for selling many things at the usual prices. The so-called department store sells its wares at prices at least as low as those of the suburban or village shop. To this statement there seems, indeed, to be an exception in the case of those shops which make their appeal to the rich, and to persons who ape the ways of the rich. Here a given article is not infrequently sold at a price higher than that charged on less pretentious premises within a stone's throw. Here high prices and high rents go together; and the dealers, if asked, would certainly explain the connection between the two by saying that, having to pay

high rents, they must charge higher prices. But in reality the causal connection runs just the other way; it is because they can get high prices that they bid high for the premises and pay the high rents. In shops of this character there is usually a stock of well-selected and attractively arranged articles of good quality; there is quiet, and, not least, there is a flattering of the purchaser's vanity by obsequious demeanor and by a suggestion of superior company. The satisfaction of the snobbish love of distinction is one of the utilities here purveyed, and is one for which most people are willing to pay handsomely.

Sites for wholesale trading command their rentals largely because of their proximity to other sites where the same or similar businesses are carried on. This advantage may seem a trifling one, especially in these days of the telephone. Yet where trading is done on a great scale, a few hundred dollars more or less, or even a few thousand, paid for rent do not signify much in the general account, and the facilitation of larger dealings leads to the ready payment of a high premium for the convenient sites. Here every sort of negotiator can run in promptly; banks, brokers, shipping agents, insurance companies, are close by. Wholesale dealers in the same trade commonly are near each other; in a great city there is the metal district, the dry goods district, the boot and shoe district, the shipping district, and so on. All together cluster about the financial center, which in turn gets its advantage from being in close touch with any and every kind of business. The most various sorts of persons, who need to be where they can easily get at their customers and where their customers can easily get at them, bid for premises near the heart of things; such as lawyers, brokers, schemers and middlemen of all kinds, the managers and representatives of manufacturing establishments. Hence the office building, developed to perfection in American cities. The largest urban rents seem to be secured, at least in American cities, on sites used for offices, for financial enterprises, and for the great retail shops. They sometimes reach an extraordinary range. An acre of land in the financial center

of New York City has a capital value of roughly $20,000,000, representing a rental of $800,000 a year.

Manufacturing sites sometimes command their price because of intrinsic advantages. They may be near water power, or to a deep-water harbor, or to cheap fuel and materials. Facilities for transportation by railway tell no less than water facilities. In the United States, where competition among railways has been active and railway rates have been lower if one line could be played off against another, a spot at which several lines meet has had advantages in much the same way as if nature had made the site good. When once a city has developed, it continues to attract manufacturing establishments, for reasons that are often not apparent on the surface. Why should a premium be paid for premises in a city, when premises apparently no less good can be had at much lower rentals in the country? Here, again, the telephone would seem to remove the drawbacks entailed by remoteness. And yet the keen calculations of shrewd business men, constantly weighing the advantage of proximity against the higher rent charge, cause the gravitation of many manufactures to the urban centers and the suburbs close to them. Easy access to customers, to supplies, to subsidiary industries, even to competitors, is one factor. Probably most important is the plentifulness and flexibility of the labor supply, to which reference has already been made,[1] and which is of particular moment in establishments whose work is subject to rapid fluctuations.

The precise point at which a city's business operations will concentrate, and at which urban rents will be highest, is often determined by no natural or inherent causes. The site of a great city itself is indeed usually fixed by natural advantages, such as a superb harbor, as in the case of New York City and San Francisco, or the confluence of rivers in the neighborhood of great coal supplies, as Pittsburg, or access to inland water routes, as Chicago. But within the city, there is usually no reason why one small area should be preferred to the others

[1] See Book II, Chapter 14, § 2.

as superior for business. It is the gregariousness of industry that gives business sites their value, just as the gregariousness of men has the same effect on sites for dwellings. Some one center will be resorted to by all, and will be prized by all; but the causes which fixed the center at Threadneedle Street or Wall Street are usually historical and complex, and sometimes whimsical.

The value of sites for dwellings is explained by the same principle, with similar complexities and similar apparent anomalies. Sometimes such sites have intrinsic advantages, — broad and sunny streets, frontage on parks and open spaces, convenience of access. But often the advantage is purely factitious. Nearness to one's kind is in many cases alone sufficient to explain the demand for some spots. Crowded, noisy, and unhealthful city streets attract the working classes more than quiet lanes in the country. At the other end of the social scale, among the well-to-do, and most of all among the very rich, snobbish differences tell enormously. Certain streets are resorted to by those who have social distinction. Thither flock all who yearn for such distinction, — a great and growing multitude, — and sites believed to be proper for the select are paid for at rentals limited only by their incomes. The very cracks and crannies of fashionable districts, narrow side streets and dark back rooms, when touched by this potent charm, command high rentals, notwithstanding their intrinsic unattractiveness.

§ 2. Something closely analogous to the tendency to diminishing returns shows itself on urban sites.

Buildings can be pushed higher almost without limit. In these modern days of steel-frame construction, ten, twenty, thirty, stories are practicable. But sooner or later the stage is reached where the gain from additions to the structure begins to diminish, and where it becomes a question whether it is not better to resort to building on another site than to push construction further on the same site. Where the land is used for manufacturing or mercantile operations, that stage seems

to be reached, in American cities, with the fifth or sixth floor. One rarely sees a building of greater height used for these purposes. The poorer light and air on the lower floors, the cost of lifting goods and materials (even with smooth-running elevators), the difficulties of supervision, begin to tell, and tell the more as more stories are added. Where buildings are used for office purposes, in the business centers of great cities they are often pushed much higher, at least in the United States. The advantage of being at the very heart of things is so great that a multitude of persons, engaged in all sorts of occupations, are willing to pay liberally for this facility; and a small city in itself is established in the towering office building. But even here there is eventually a limit, though one which the progress of invention is steadily pushing higher. It must be borne in mind, in any case, that all the sites cannot be used in this way, for then the buildings would cut off too much of each other's light and air. Hence adjoining sites must be controlled and limited; in other words, taking the combined sites, the possibility of intensive use is much more limited than it appears to be when a single plot is considered by itself. Situations on a corner, or those which face a public square or other open space (like Trinity churchyard on Broadway in New York City), offer the possibility of investing an enormous capital on a given area.

Much the same is true where dwellings are put on urban land. Here, also, buildings can be made taller, thus securing very intensive use of sites advantageously situated in large cities. Dwellings for the very poor as well as for the very rich can be pushed high; tenements for those who must be near their work (or think they must be) and near their comrades, and great mansions or apartments for those whom fashion attracts to "choice" sites. But eventually, even with steel frame construction and with elevators and telephones, a limit is reached where it begins to be less profitable to add more and more stories. The tendency to diminishing returns, under the increasing application of more and more labor and capital to the utilization of the same site, finally asserts itself.

This tendency does not act so steeply on urban land as on rural land. On a plot used for agriculture, diminishing returns are encountered at a comparatively early stage. It is true that for certain purposes — as for market gardening or vineyards — very intensive use can be made of a few agricultural sites; precisely as highly intensive use is made of a few urban sites. But in almost all cases diminishing returns are reached comparatively early on agricultural land, and the obstacles which cause a lessening of product act steeply. On urban land, on the other hand, the obstacles appear more gradually, and hence there is a larger choice between the more and the less intensive use of the sites. One will find, side by side, on the same city street, very high buildings and comparatively low ones; indicating that as regards the additional stories on the high buildings, there is neither any great gain (over and above return on the cost of construction and management), nor any sharp tendency to a lessening of return, as the building is pushed higher. It would seem that very large amounts of capital can be invested on some urban sites, especially on business premises, with a prolonged stage at which returns are nearly constant.

§ 3. On urban land, as on agricultural land, there is no separate product of the land. Nothing is automatically yielded by the site; nothing is earmarked as "rent." What happens is that labor and capital applied on some sites yield unusually large returns, and that, the sites being limited, the owners are able to keep for themselves the excess of return over and above what is usually got.

The yield on the advantageous sites depends in no small degree on the skill with which they are used. Their possibilities are not seen by all persons. The bidding for them comes most actively from those who have the shrewdness to see what can be done on them and the courage to put their calculations to the test of actual trial. Mistakes are sometimes made, and losses incurred, by those who lease or buy city land on high terms; while at other times success and unusual profit follow from its ingenious utilization.

For example, the office building which is so striking a feature of American cities is the result of a process of gradual evolution. Successive sets of persons have devised more and more elaborate utilization of central sites, — new methods of construction, higher buildings, more convenient service. Each improvement entailed a certain risk; each, if fortunate, promptly had a host of imitators. Each successful venture inured to the advantage first of the owner of the particular site, and later to that of the owners of similar sites. Very commonly, in American cities, the innovator who has in mind a new use of the land (say through a more elaborate building) will buy it outright from the previous owner at a price based on the traditional ways of using it. Then, if he succeeds in his venture, he finds the return on his total investment handsome, and his site worth in the market more than it was before. Sometimes he leases the land for a long term, and so enjoys the gain during the period of his lease. Sometimes the owner himself is shrewd enough and energetic enough to use his site in such a way as to get the maximum yield. In whatever way the more effective and profitable utilization comes about, it soon has plenty of imitators, and the new method becomes the common one for sites of the same sort; to be succeeded in due time, especially if the city continues to grow, by other still more ingenious methods. But success does not invariably follow. Mistakes and miscalculations occur, as in every kind of investment. Often enough it happens that a projector pays high for a site, and erects an elaborate building, perhaps one adapted to special uses, in the expectation of meeting a brisk demand for the quarters provided in it; but finds that he has overestimated the growth of business in the city, or the demand for the particular accommodation which he offers.

In every large city there are so-called "real estate men" who make it a business to manage investments in urban realty, partly for themselves, partly for others. Among them a process of selection causes the less shrewd to drop out, the more shrewd to come to the fore. Usually there are some among them who

are gifted with a sort of instinct for discerning the possibilities and adaptations of the various grades of city land, and they commonly make handsome returns, sometimes fortunes, either from the purchase and sale of sites or as managing agents for the owners. They set the pace, so to speak, and are followed by the rank and file. There are always others, equally venturesome but less shrewd or less fortunate, whose experiments do not succeed, and who lose money for themselves and their backers. The spur of individual profit and the stimulus of competition are no less necessary here than in other parts of the industrial world for the most effective employment of the factors of production. And here also the difficult problem is that of so adjusting rewards that enough shall be earned by projectors and managers, and not more than enough, to induce the full exercise of their industrial talents.

§ 4. The investment of capital on urban sites is usually more irrevocable than on rural sites. It is true that there are agricultural improvements, such as operations for irrigation or permanent drainage, which last indefinitely, and which, when once made, are irrevocable. But most work done on farms exhausts its effects in a short time — usually in a few years — and the choice recurrently presents itself whether any particular application of labor and capital shall be repeated or shall be discontinued. The investment of capital on urban land, on the contrary, is usually such that the improvements last a very long time, and hence that a change is made with difficulty.

Thus, in many seaports, tide flats or shallow stretches have been filled, and deep-water sites secured. For such an investment there is no wear and tear, and no possibility of shifting the capital in the manner in which it may be shifted when invested in machinery, — by letting it wear out, and replacing with something else. The changed land surface is there once for all. So it is whenever land has been leveled or filled. The case is similar, though not so extreme, with buildings. It is true that buildings do not last forever; but they may last for

generations, even for centuries. Commonly they have to be kept in repair, in order that they may be used at all. So long as they yield anything over and above the expense of repairs, it is worth while to maintain them, even though the yield be but a very slight return on what has been invested. It will be profitable to tear down an old or ill-adapted building and replace it with a new building, only when the new one promises to yield not only enough to pay a satisfactory return on its own cost, but in addition enough to compensate for the loss of net revenue which the old still yielded. Consequently the antiquated structure, even though it does not utilize the site in the best way or to the full extent, remains undisturbed for a long time, yielding such a return as its conveniences may make possible. Where a city is growing rapidly, the demand for new structures will cause the stage to be reached at a comparatively early date when it will pay to raze to the ground an obsolete building, and substitute something new and up-to-date. Where a city grows slowly, still more where its population is stationary, such a building, especially if thoroughly put together and in little need of repairs, may remain in use indefinitely long.

In other words, when once an urban site has been adapted to use by an investment of capital, — and the common and typical mode of investment is that of erecting a building on it, — the return on it is irrespective of the extent of the investment. The parcel of "improved" realty — land and building as one complex — earns an amount determined solely by its serviceability for business or dwelling uses. It is only in the long run that the difference becomes clear between rent and interest, — between that return which goes to the owner of the site as such and that which goes to the owner of the capital put on it. As time goes on, buildings do wear out, old ones are torn down, and new ones are substituted in their place in order to put the land to its most profitable use. Landowners as such then secure the full differential gain which their site is capable of affording. But the slowness with which

capital invested on land can be shifted may prevent for a long time the attainment of this maximum.

None the less, it is usually possible to ascertain with a good degree of accuracy what is the gain or rent accruing from an urban site as such. While the ways of using it change from time to time, there is at any given stage an established or normal utilization, just as there is at any given time an established or normal method of manufacturing cotton goods or boots and shoes. It is practicable to measure what are the income-yielding possibilities of the site as such under these normal conditions. Hence the selling value of the land, which is based on its income-yielding possibilities, can also be measured with sufficient exactness. It is so measured, in the higgling of the market, by the current sales of land. It is measured by the assessment of land for purposes of taxation. The rent which the landowner gets, though it is not earmarked as a separate return, and though it is much affected by the use to which the site happens to be put, is none the less distinguishable from the interest which goes to him, or to some lessee, upon an investment of capital in the land.

It may seem that the difference between rent and interest is clear in the case of land leased for a ground rental. In Great Britain urban sites are commonly leased for a long term (usually ninety-nine years), and built on by the lessee. Leases on ground rent are not unknown in American cities, and are becoming more frequent; though the common custom here is still for the landowner to put up the building himself. When ground rent is paid by a lessee to the landowner, the amount received by the latter is almost always economic rent pure and simple. In Great Britain where the owner of the site customarily does nothing whatever to improve it, his income seems to be clearly of this nature.

But it by no means necessarily follows that the whole economic rent of the site goes to him; and it is conceivable that he may receive under his lease more than that rent. The long-term lessee may pocket, for many years, part of the strict

rent of the site.[1] The increase of population, or its greater concentration in a particular city, may cause the site to become more advantageous than it was expected to be when his lease was made. The buildings which the lessee erects on it may bring a return much more than sufficient to pay interest and depreciation; there is a surplus, which accrues to him through his lucky bargain. It is possible, of course, that the reverse may happen. The site may become not more advantageous than was expected, but less so; and the landlord will then receive under his bargain more than his site proves to be worth. During the last hundred years, when population in all the civilized countries has not only grown, but has crowded more and more into the cities, much the more common experience has been that ninety-nine year lessees have pocketed part of the site rent. When long leases of this sort reach the end of their term, there is sometimes a wonderful accretion for the heirs or successors of the lessor of a century before. An ancestor of the Duke of Bedford in the eighteenth century leased large tracts on what was then the edge of London, for ground rent. Ninety-nine years later, when the land was in the heart of the great metropolis, his descendant reaped a huge harvest of urban site rent Such windfalls bring into sharp relief the meaning of "unearned increment," and they suggest also questions as to the possible limitation of private ownership in urban land, to which we shall presently give attention.

§ 5. Reference has been made to "real estate men" and to the higgling and bargaining by which the prices of city sites are fixed. Speculation in urban land is a familiar phenomenon in modern communities. Especially where the law of real property makes easy the transfer of title, sites are bought "for a rise," and are passed from hand to hand at fluctuating

[1] In the city of New York leases of sites are often made for twenty years at a stipulated rental, with privilege of renewal for a second and perhaps third term of twenty years; the rentals for the additional terms to be fixed by arbitration, or on the basis of a fixed percentage (four per cent, say) of the appraised selling value of the land. Such an arrangement makes it more certain that the landowner will secure the full economic rent.

prices according to the calculations of sellers and buyers. In cities that grow rapidly, or are expected to grow rapidly, the speculation is sometimes furious. The bidders for promising sites overreach themselves, and in the end some among them incur heavy losses; while others, more shrewd or fortunate, pocket handsome gains from the accruing rise in the value of land or from the mistakes of their fellow speculators.

In all this there seems to be purely unproductive labor, as that phrase was defined before[1] No small amount of energy and skill is given to figurings and calculations, bargainings and perhaps intrigues, whose outcome is simply to cause one person rather than another to get the gain from growing site value. From the social point of view, this seems to be waste. True, it is not quite like ordinary gambling, where one person gains precisely what the other loses. Unless real estate speculation be overdone, one person gains only something which another fails to gain. Nevertheless nothing appears to be contributed to the community's income.

This in the main is true; yet it is subject to some qualification. Speculation in city land does contribute something to the community's welfare, in so far as it promotes the most effective use of the land. It stimulates those who are engaged in it to ferret out all the possibilities. It tends to bring the land into hands which will utilise it to the utmost. The successful speculator is commonly a projector who hits on new and more effective uses of the sites, or a person who fraternizes with such projectors and weighs their schemes with judgment.

Here, as in almost all of the working of the system of private property, the question is one of the balance of advantage and disadvantage. Much the same question presented itself in the discussion of speculation in commodities, such as grain and cotton.[2] Speculation, whether in goods or in land, has its advantages for the community; but more persons engage in it, and more labor is given to it, than is necessary to secure that

[1] See Book I, Chapter 2. [2] See above, Book II, Chapter 11.

advantage. There is no small diversion of time and energy to what must be termed unproductive operations. How far these can be restricted without sapping the inducements to improvement is part of the fundamental problem of modern society, — that of promoting both progress and equality.

Speculation itself, whether of the serviceable or the unproductive kind, is one of the factors on which rests the demand for urban business sites What proximately determines the demand for such sites is the facilities they afford for money-making. While pecuniary gain arises commonly from the use of sites in ways that really add to the well-being of the community, — as when premises are used for trade or manufacturing, — it may come also when a site is used for gambling operations. A great lottery, if permitted to exist by the law (as it still is in some European countries, to their shame), would pay handsomely for premises in the heart of a great city. The brokers through whom speculative gambling is carried on are among the most insistent bidders for quarters in the financial districts of large cities; for they must be near the center of things to reach their customers and execute their customers' orders.

§ 6. Urban land values and urban rent are sometimes *created*. As has just been said, the precise point at which a city shall arise is not settled solely by natural causes; still less do such causes settle the precise spot within a city which shall have large site value. Projectors sometimes try to direct the forces that bring urban rent into existence. A large industrial enterprise or set of enterprises may be established in a small village, or on a spot where there had not been even a village, in the expectation that about it a city will grow up, with its attendant land values; the owners (or managers) buying up the land in advance and expecting to profit by its sale or lease. Thus the Pullman Company established the town of Pullman, near Chicago. The Steel Corporation deliberately created Gary. A great railway company, by placing its workshops at one spot or another, may influence markedly the growth of a city. And within a city the same sort of intentional direction of the

urban currents may be attempted. Two or three great firms or banking houses may transfer their operations to a new street and carry business after them. Similarly, as to sites for dwellings, persons of wealth and social repute may move to a new district, and give it the prestige of fashion. By purchasing in advance the sites they propose to bring into favor, they may secure for themselves the newly arising land values.

In most such cases, it is true, land values are guided or diverted, rather than created. If population is the same, and is distributed in the same way, site rent is sure to arise in any event. Then it is possible only to cause it to appear in one place rather than another; not to add to its amount Yet there are cases where its amount may be affected, as in the skillful development of a "residential" suburb or section, or in that of a well-planned manufacturing center.

All such operations, however, whether they create or merely divert urban values, are attended with risks even greater than those of ordinary investment on the land. Where, for example, a new city is sought to be created, streets must be made; water mains, sewers, and other conveniences put in; and the whole depends for its profit on the fulfillment of the expected growth. Some years ago, a set of projectors tried to create a manufacturing town named Depew near the city of Buffalo, and spent much money in preparatory operations. But they found it difficult to get either industries or people to betake themselves to Depew, and the final outcome was failure and loss. So it may be with attempts to turn urban currents toward new streets or outlying districts. The favor of the crowd — whether it be a set of business men or of the idle rich — is proverbially fickle. Here, again, shrewdness and personality tell. Some individuals will successfully undertake such ventures and overcome obstacles, where others will fail. The higher site values which may be attained in places so developed will not represent economic rent pure and simple; they will be, to a greater or less degree, compensation for risk and earnings of managing activity.

There are cases, on the other hand, in which the risk is small, even negligible. When a government establishes a great workshop or a large educational institution, it is well-nigh certain that population will be directed to the favored spot, and that some influence on site values will appear. When an important railway fixes on a given town as its "division point," that is, a center for administration and operation, or places its manufacturing and repair shops there, the result is no less certain. It may chance that the managers and directors of the railway, who know in advance what is to happen, can then make money by clandestine purchase of sites, — a semi-corrupt abuse of positions of trust which unfortunately has too often appeared in connection with railway management in the United States. In such cases, the gain should be reaped, if by any individuals, by the stockholders of the railway as a whole, not by a clique of managers. Better still, it should be reaped by no individuals, but should go to the entire community.

CHAPTER 44

Rent, *concluded*

§ 1. Mines present a case in some respects similar to that of urban and agricultural sites, in some respects different.

There are obvious differences between individual mines. Some are richer than others. or more advantageously situated, and these yield a differential return to their owners. If we assume free competition and mobile investment, we may reason that, as the demand for a given mineral (say coal) increases, more and more mines will be put in operation, — the most productive first, then those less so; that the coal will normally sell for enough to repay all expenses of production on the margin, that is, at the poorest mine in use; and that all better mines will yield a surplus income which is strictly rent.

But the conditions of mobile investment hold good only to a limited degree of mines. Mobility of investment presupposes not only ease of transfer for capital, but also a generally diffused knowledge of the prospects of profit. Neither of these conditions obtains in mining, which calls for an irrevocable and usually very large investment, and involves a high degree of risk and uncertainty.

There is some risk in all use of the land. The risk probably is least in the long run (that is, over a series of years long enough to equalize the accidents of the seasons) in the case of agricultural land; for the possibilities of such land are readily discerned by any capable farmer. It is greater in the case of urban sites, where there is the chance of ill-adapted buildings, of shifting population, of the caprices of business movements. It is greatest in the case of mines; though varying again for different sorts of mines. Even though prospecting is sometimes facilitated or encouraged by a preliminary geological and physiographic survey (such as, for example, that which ascertains

the carboniferous area of a country) and even though it may thus be known that abundant mineral underlies a given area, — none the less, expensive trial is needed to ascertain how much there is, of what quality, of what ease of procurement. When once a coal mine has been opened and put into operation, it is usually possible to judge how long the supplies will last and what will be the expense of getting them to market; but even this is in some part a matter of guesswork. The case is similar with iron ore. Here, also, drilling and prospecting will often show how large, how good, how accessible, is the ore body; but this preliminary knowledge is got only by scouring a wide territory. A multitude of failures in "prospecting" is relieved by occasional success. Where minerals occur in pockets, the chances both of failure and success are greatest, and the miner's operations are akin to gambling. Such was the case with the so-called bonanza mines of the precious metals in Nevada. Some discoveries of extraordinarily rich pockets of gold and silver brought fortunes to their owners. On the other hand, there were unnumbered failures, tempted by deceptive surface indications. Copper mining is notoriously uncertain and speculative. In all such cases, even when the first excavations are promising, there is a stage of doubt, when capital must be invested in the form of shafts, machinery, concentrating and smelting works. Venturesomeness, judgment, persistence, and efficient management are essential to ultimate success.

Where there are many losses, there must be corresponding gains. The traveler through such states as Colorado, Nevada, Montana, Idaho, Arizona, California, sees the sides of the hills and mountains scarred by innumerable openings, each with its telltale pile of rock. The immense majority of these ventures were failures. Were it not for the chance of some great prizes, all this necessary work of exploration would not have been undertaken. Under such conditions a high return on the lucky ventures does not constitute a true surplus. Nor is it easy to say whether, on the whole, the gains in successful min-

ing ventures suffice to offset the losses in the unsuccessful. Prizes often have an undue effect on the imagination. The unfailing attractiveness of a lottery (in which it is obvious that the speculators as a body must lose) proves that where there is a chance of great gain from a lucky stake, men will often pay for the chance more than its actuarial value. As has already been noted, there is ground for supposing that in mining for the precious metals in former times the total outlays were not recompensed by the total net earnings.[1] At least a possibility of the same sort exists as regards mining operations in general.

It is probable that in many mining ventures the risk is less now than it was in former days; while, on the other hand, the need of large initial investment is greater. With the advance in geological and mineralogical knowledge, it is much more possible to infer from the surface outcrop or from experimental borings the quality and quantity of what is underneath. The improvements in treating ores have made available low-grade ores of gold, silver, copper, lead, such as occur, not in pockets, but in continuous veins. This is the case, for example, in the gold mines of South Africa, from which so great a supply of gold has been secured during recent years. Here mining operations, when once the body of ore has been found, are in no great degree speculative; and the yield on the better sources of supply has more the nature of a true surplus or rent. The same is the case with much mining of iron ore and coal in modern times, where the mineral body can be surveyed and appraised in advance with some measure of certainty. None the less, — especially in view of the heavy investment in diggings and machinery required by modern mining methods, — risk is greater than in most industrial operations above ground.

There is, in a sense, a tendency to diminishing returns in mines. Yet in this regard, also, the general reasoning which underlies the principle of rent must be qualified in its application to mining.

[1] See Book III, Chapter 19, § 1.

In any one mine, there is often — probably in a majority of cases — a tendency to lessening yield with increasing depth. Pumping to keep it free of water becomes more costly, and minerals must be hoisted farther to bring them to the surface. So it is with the tin mines of Cornwall, which, after centuries of working, have now been extended beyond the shore line far under the bottom of the sea. It is the case, too, with the anthracite mines of Pennsylvania. And, in the end, every mine reaches its absolute limit. A mine is not, like agricultural land or an urban site, a permanent instrument, enabling the investment of capital to be continued without limitation of time. Its store is fixed, — even though sometimes very large, — and when that store is exhausted, there is not diminution of return, but complete cessation.

Against these tendencies to diminishing return and ultimate exhaustion must be set the possibility, even the probability, of the discovery of new sources of supply. The total land area available for agriculture (even though there are sometimes unexpected openings) is known with sufficient accuracy. But what is contained in the bowels of the earth, must always be more or less uncertain. The nineteenth century was marked by the finding of wonderful mineral resources. In Great Britain there was the discovery of the great Scotch iron ore deposits at the opening of the century, and of the Cleveland deposits (on the Northeast Coast) in the middle. In the United States, after the coal deposits of the Pittsburgh region, came those of Ohio, Indiana, and Illinois. Not less important were the great copper deposits of Michigan, Montana, and Arizona, discovered successively after the Civil War, and the iron ore deposits of the Lake Superior region, of even more recent exploitation. The gold mines of South Africa have been found within the same recent period. It is known that there are other untapped resources, such as the great iron and coal deposits of China, the coal regions of Alaska; and there may be still others not yet dreamed of. Notwithstanding the limitations of each single deposit in the earth's crust, mankind may look

forward, for long ages to come, to an increase rather than to a diminution of its available mineral resources.

§ 2. The owner of a mine, when he leases it to another for working, usually gets a royalty, — a fixed payment of so much per ton. Royalties naturally vary with the quality of the minerals and the ease of their extraction. They are a rough-and-ready way of carving out the economic rent. They are not necessarily in the nature of rent; for where a mine has been found by "prospecting," with all the risk of possible failure, the payment may stand for no real surplus. But where royalties are paid in well explored countries, on minerals whose quality and value are reasonably well known, they are simply rent. Such seems to be the case with the royalties on English coal mines.

It is argued by some able economists[1] that a royalty is in any case different from rent; or rather, that there is on every mine some sort of payment to the owner, or revenue for him, and that even the poorest mine will yield something in the nature of a royalty. The better mines yield in addition a true rent, disguised as a further or ampler royalty payment. The ground for this contention is that a mine contains a fixed store, and that the owner will not consent to its *pro tanto* exhaustion unless he receives some recompense. But I am skeptical of the validity of this reasoning. The fact that a store is physically limited does not enable its owner to secure a price. Sand and clay are thus limited; but the available quantity is so abundant that a clay pit or sand deposit is worth nothing unless it has an advantage of situation It may be doubted whether any payment at all, royalty or what not, can be secured by the owner of the very poorest mine, — assuming he has done nothing to develop it. Deposits of this sort are at the margin of utilization and at the margin there is no surplus of any sort. Probably no mine in its entirety is on the margin;

[1] This is Professor Marshall's view; *Principles of Economics*, Book V, Chapter X, § 6 (6th edition). It was also Ricardo's view; *Political Economy*, Chapter III. On the whole subject, see Professor L. Einaudi, *La Rendita Mineraria*.

just as no farm in its entirety is on the margin. Good bits are mixed with bits less good, and the actual payment is adjusted by a rough-and-ready process, in which account is taken of the whole of the natural opportunities as well as of all the expense and risk of development. Here, as in every part of the economic field, the concrete phenomena show only an approximate correspondence with the sharply stated theorems that serve to indicate their general trend. But rent proper shows the same sort of development on mines as on other natural agents.

§ 3. The selling value of a natural agent — be it agricultural land, an urban site, a developed mine — is a capitalization, at the current rate of interest, of the fixed income which accrues to its owner. It varies, therefore, inversely to the rate of interest. Suppose a building on a given site is to cost $100,000, and promises a net income or commercial rental of $15,000 a year; then if the rate of interest be 5 per cent, the investor will readily pay $200,000 for the site. On his total outlay of $300,000 he will get $15,000, or 5 per cent. If the rate of interest should fall to 2½ per cent, the same site would sell for $400,000. The differential advantage of the site would remain as before, — worth $10,000 a year; and the buyer would get 2½ per cent on his investment by purchasing the site for $400,000. On the $100,000 invested in the building he would be compelled by competition to accept the current interest rate of 2½ per cent, and the total rental would be $12,500, not $15,000. The decline in the rate of interest would lessen the return on the building (considered alone), but would double the value of the land. The lower the rate of interest on freely offered capital, the higher the sum which will be paid for any piece of property which yields a fixed return.

The same principle applies to what are known as guaranteed securities, — the shares of corporations, such as railroad corporations, which have been leased on fixed terms. Thus one railway may be leased (virtually bought up) by another, with stipulation to pay an annual sum equal to 10 per cent on its

shares. If the current rate of interest is 5 per cent, each share of the leased railway (par value being assumed to be $100) will sell for $200. If the rate of interest is 4 per cent, it will sell for $250; if 2½ per cent, for $400.

The selling price of land is affected, of course, not only by the process of capitalizing its present rent, but by the expectations of the owners and of the investing and speculating public concerning the future. In a growing city, an advantageous site will command a price more than in proportion to its present rent; because it is expected that the rent will increase still further as the years go on. Conversely, a doubt as to the future of the site will cause it to sell at a price lower than its present rent would determine.

§ 4. The same problems of public policy arise for urban land as for agricultural land. There is here an unearned increment, due to the increase and thickening of population, and ascribable in slight degree, if at all, to the labor or care of the fortunate possessors. There is a differential return over and above what is necessary, on the most liberal estimate, to induce the adaptation of the site to its most effective uses. Why should not the community appropriate this return?

This question is presented more sharply in the case of urban land than in that of agricultural land. In the first place, it is usually possible to ascertain with more accuracy just what is the site rent and the site value of urban land. We have seen that for any specific plot of agricultural land which has long been in use, there is great difficulty in determining how much of its productivity is due to natural advantages, how much to man's action. That difficulty is much less for urban plots. It is almost always possible to state at least a minimum sum which represents the differential advantage of the site pure and simple. Something must be allowed, it is true, not only for pure interest, but for the risk and labor involved in building and management. But after the most liberal allowance for all such items, a surplus remains. In other words, it is possible to set aside some part of the gross return which is clearly rent for the site.

In the second place, urban rent is usually concentrated in fewer hands, and gives rise to wider inequalities of wealth and income. Urban rent may or may not be in the aggregate greater in amount than agricultural rent. In countries like Germany and France, agricultural rent is probably at least as large. In England, where much the greater part of the population is gathered in cities, and where the free importation of foreign produce checks the growth of agricultural rent, urban rent is no doubt much larger in the aggregate. It probably is so in the United States also; for the abundance of farming land and the efficiency of the means of transportation have limited agricultural rent, while the increase of city population has vastly enhanced urban rents. But, in any case, urban land is usually in fewer hands. Though the agricultural land of Great Britain is concentrated in comparatively few hands, and in Austria, also, there are vast estates in the possession of a small number of titled proprietors, the ownership of agricultural land in France, in southern and western Germany, and in the United States, is widely diffused; and its economic rent is dispersed among millions of proprietors. Urban rent, on the other hand, flows into the hands of a much smaller number of persons, and among these a few receive great amounts. The Duke of Westminster and the Duke of Bedford are types of British peers who have been enormously enriched by the ownership of urban sites and the falling-in of long-term leases. John Jacob Astor, in the early years of the nineteenth century, became the owner of sites in New York whose value, in the course of the century, became almost fabulous; his descendants not only enjoy this yield, but have greatly enlarged the family holdings, until their income has exceeded that of dukes and princes. The same thing has probably happened in every American city. Certain "old families" — usually founded by an ancestor of the successful business-man type — have become rich from the growth of the community. It is true that tenacious holding of the land by successive generations of the same family is much less common in the United States than in Great

Britain. The ease of transferring the title to land, and the habits of speculation, have caused a dispersion of urban rent in our own country, and a parceling of the increment among a succession of purchasers. None the less, in the United States as in other countries, urban rent has been a cause of conspicuous inequalities in wealth.

Hence the proposal to appropriate for the public the whole or a part of rent is urged more insistently for urban sites than for agricultural land. It seems to me impossible to deny that if a reservation of rent for the community had been made from the start, with due care and discrimination, the community would have been better off. The effective utilization of the land would not have been retarded, while a lessening of the general tax burdens and a check to inequality would have been brought about. Careful and discriminating management would, indeed, have been essential. The quinquennial or decennial carving out of economic rent would have raised delicate questions as to how much allowance should be made for the return necessary to enlist shrewdness and enterprise. A rough-and-ready administration of such a system, still more a grasping one (and public administration is too apt to show one or both of these characteristics), might bring more harm to the community in checking the utilization of land than good in capturing the unearned increment.

The leasing of land on long terms by the state, which was suggested among the possibilities as to agricultural land, would have been no less possible as to urban land. A lease for ninety-nine years is as good as a fee, so far as the promotion of investment goes. No doubt, if land were held on such terms from the state, the holder during a large part of the ninety-nine years might secure a handsome slice of the accruing site value. But at least when the end came, the community would reap its gain. Much shorter leases — for fifty or even twenty-five years — could conceivably be drawn, with provisions for compensation to the improving tenant such as would allow sufficiently free play to the investment of capital. Land leases for

such terms are not uncommon in the city of New York (*e.g.* on the Astor properties) and are not found incompatible with the most intensive utilization of the sites.

In the case of mines, it is difficult to see how any other method than that of long leases could secure the two desired ends, — the effective utilization of the resources and the conservance of the public's fundamental equity. The uncertainties of mining are such that any recurrent carving out of economic rent is quite impracticable. The only feasible policy would be that of allowing private enterprise to take its risks and reap its rewards over a stated period. No doubt the possessor or tenant during his term would be tempted to work the mine to the utmost and perhaps exhaust it; a difficulty possibly to be met by requiring the payment of a progressive royalty as a large output was reached. Here, as elsewhere, occasional great gains to lucky or shrewd investors must be accepted with equanimity; a policy too grasping overreaches itself.

All this, however, is little more than idle speculation, at least so far as the past is concerned. No community has reserved to itself, by lease or by periodic levy, the right to the unearned increment. Historically, it could not be otherwise. Private property in land was an indispensable instrument for the advance of civilization. Surveying the history of European industry and the growth of European cities, we cannot see how advancing arts, free enterprise, accumulating capital, could have been secured without the instrument, comparatively crude as it may seem, of unqualified title to land. The new countries of modern times — the United States, Canada, Australia, Argentina, and the like — might conceivably have started with a more far-sighted and more complex system of land tenure. In fact, they have not done so. The force of tradition and habit, the rapacious desire of the pioneers for the unrestricted fee, ignorance and indifference as to the underlying economic principles, have led them to follow the ways of old countries, and to accept the established principles of the unqualified law of real property.

Hence the problem of vested rights in urban land stands as stubbornly in the way of the ardent reformer as it does for agricultural land. The purchase and transfer of urban sites has gone on from time immemorial in the same way as that of farming land. To the present owners, the capitalized value represents an investment or an inheritance, precisely as does the present value of anything which is capital in the strict sense. Here, again, unless the whole institution of private property be remade or abolished, the existing rights to land, as they have been allowed to develop through the centuries, must be respected.

§ 5 The question is different as regards the rise in rent that is still to come. There is no vested right in the indefinite future. The proposal that the future increment shall be reserved for the community was made fifty years ago, chiefly with reference to agricultural land, by John Stuart Mill and other reformers. But the advantages of unrestricted property in agricultural land, especially where wide distribution of ownership prevails, and the difficulties in the way of carving out economic rent with any accuracy, — these considerations have led to the rejection of Mill's proposal, as to agricultural land, by most economists of the later generation. On the other hand, with the rapid growth of modern cities and the unmistakable swelling of site rents, a reservation of the community's rights with respect to urban land has met with steadily increasing recognition. The form in which this right is most likely to be asserted is that of a special tax on the newly accruing increase in site values. In strict theory, the whole of this increase might be taken through taxation. No doubt, in estimating the increase, allowance would have to be made for all the factors which have been discussed in the preceding chapter; and the process of securing the whole of the strict surplus, and no more, — leaving the owner enough, and only enough, to induce the effective utilization of the site, — would be a very delicate one. But it is not likely, so long as the institution of private property remains, that there will be so drastic

an application of the principle. No proposal that has now a prospect for adoption contemplates taking more than a slice of the future increment. In Germany, where so many movements toward social reform are being carried on in deliberate and well-planned fashion, the recent (1911) imperial legislation for taxing gains in site value did no more than appropriate (at the highest rate) thirty per cent of the increase.[1] The hotly debated British tax of 1909 took twenty per cent. It may be that this is only a beginning; and those who oppose it will maintain that eventually everything will be taken, and that in the end existing values as well as newly accruing gains will be appropriated. But such objections are urged against every proposal for social reform, and, if allowed, would prevent any disturbance whatever of the *status quo*. The day is gone by when they are felt to be insuperable. The dogma of an unrestricted right of property, and the belief in the expediency of the exercise of that right without a jot or tittle of abatement, have been shaken beyond repair. The rights of property must approve themselves on examination in each particular case, and must submit to modification where a balance of gain for the public can be reasonably expected.

The growing demand for taxes on unearned increments, and the actual enactment of legislation in Germany and England, make the *modus operandi* important: how proceed? The problem is by no means a simple one. The accruing increase of rent is the thing which, in the last analysis, it is desired to divert to public use. But what emerges most openly is capitalized value. The easiest way of adapting the machinery of taxation to the phenomenon familiar to all the world is to tax in proportion to the higher selling price of land. To tax the increase in selling price may indeed seem to accomplish the same end as to tax the growing rent; since the price is but a capitalization of the rent. Yet there are difficulties and complications.

[1] But this maximum (30 per cent) serves to limit the imperial tax only. The local bodies (cities) are allowed to add supplements to the imperial tax, and thereby bring the virtual maximum to 45 per cent.

In the first place, regard must be had to all the factors that bear on selling price. A fall in the rate of interest, for example, operates *per se* to raise the price of sites; and this has been among the causes of the advance in the value of American urban sites during the last thirty or fifty years. Again, a change in the general range of prices will affect the prices of land also. All projects for measuring the rise of rents assume stability in the monetary system; care must be taken that this assumption is justified. Present selling prices are also affected by the expectation that the existing rent will rise or fall in the future, as cities grow or decline or as any given district rises or falls in favor. For various reasons, changes in capital value are by no means automatic indications of the changes in actually accruing rent.

More important are difficulties in the mode of levying taxes on an accretion of capital value. If collected from the buyer, they tend to defeat themselves. If a buyer of land knows he must pay a tax of, say, 50 per cent on the increase which has taken place in the value of a site since the last purchase, he can offer so much less for it. The very process of exacting a tax on increasing value tends then to obliterate the overt evidence of increasing value. Usually, however, the proposal is for the collection of the tax from the seller. This being the case, the buyer pays the full value of the site, and the seller is mulcted by the taxgatherer for part (conceivably the whole) of the increase in value. But this process tends to prevent the seller from parting with the site; he will hold it, and secure the site rent for himself, rather than sell subject to a tax. There will be a certainty of securing the accretion only if land is periodically valued, or if its transfer by inheritance is made the occasion of levying the tax,—devices which are not impracticable, but miss that familiar and conclusive evidence of increasing value which is supplied by a sale. And in any case, the retention of the land in the same hands, under the deterrent effect of a tax on seller's increment, operates to keep the land from its fullest utilization. The buyer who would offer a high

price for the site is the person who knows how to put it to most effective use; a tax on what the seller would receive from him tends to keep it in the hands of the inert and unprogressive.

There is still another objection to taxes on seller's increment. They are, so to speak, a sale by the public of its birthright. The buyer pays the full capitalized value, and pays it (*via* the seller) to the taxgatherer. In effect, he buys a rent charge in perpetuity. The state parts with its principal; in consideration of a sum paid in at once, it parts forever with its right to appropriate the accrued increase of site rent. This is unthrifty, in the same sense in which it would be unthrifty for an individual to spend his principal rather than his income. And obviously the process contributes to the perpetuation of the leisure class. The buyer and his descendants buy the right to collect for the unlimited future the site rent whose capital value has been paid over to the public.

Hence it would seem to be, in principle, much preferable to levy all such taxes, whether their intent be to capture a large slice of increasing rent or a small one, with reference to the economic rent itself. This is doubtless not in accord with existing practises in the purchase and sale of real property; and in the United States it is also quite out of accord with the existing custom of levying all local taxes on the capital value of property, not on the income. Hence it is a method difficult of adoption, — particularly so, because tax changes of every sort encounter more vehement opposition than any other kind of economic readjustment. Yet the periodic assessment of site rent is in itself not more difficult than the periodic assessment of site value. The site rent, or whatever part of it is to be secured, could be subjected to an annual charge, with revaluation every five years or every decade. Selling value would adjust itself to the diminished share left the owner, modified (as now) by changes in interest rates, but not affected by prospects of rise or fall in the rent. The chief difficulty inherent in this method would appear for vacant land, — urban sites whose potential rents are high, but which for the time

being are withheld from use by their owners. They may have high capital value, but in their existing undeveloped state no rent at all has accrued. To leave them untaxed would contribute to keeping them undeveloped. Our existing American system of taxing vacant land on its capital value does operate *pro tanto* to hasten its utilization. Yet to tax them in full on an estimated potential rental (or increase of potential rental) would be a troublesome matter, in view of the fact that *all* such land cannot possibly be brought into use at once, and all of it cannot be made to yield a rent at once. Some sort of compromise would seem to be called for, — a partial tax, perhaps at half rate, on such potential rents: enough to bring pressure on the owner to utilize the site.

Like all movements for reform which involve the application of a new principle, this one will have to proceed by slow steps, and with as little departure as possible from existing traditions and practises. I know not whether it will ever prove possible, under the present organization of society, to attain a really discriminating method of dealing with the problem. Though the principles which underlie it are among the most settled in the theory of economics, they bring a shock to the common notions about the sanctity and stability of real property; and their application involves a disturbance of the common ways of dealing with real property. The movement for taxing the unearned increment on urban sites is certain to grow in strength, and to bring results in legislation; but the precise mode in which it will proceed will be affected by compromises and half measures.[1]

[1] Let the reader compare, on this topic of the taxation of sites, what is said below, Book VIII, Chapter 68, concerning taxes on land and real property.

CHAPTER 45

Monopoly Gains

§ 1. The differences between natural agents, bringing about the phenomenon of rent, constitute one great cause of variations in the yield from labor and capital. Rent has often been said to be due to monopoly. But this is not an accurate statement. The characteristic of monopoly is single-handed control over the total supply. Rent is not due to control over the supply by any landholder or combination of landholders; it is due to the scarcity of the better sources of supply. But monopoly is similar to land scarcity in that it causes unusual returns to some enterprises, and so contributes to inequalities in the distribution of wealth and income. Of its regulation we shall say little here. The present chapter is concerned only with its relation to other gains from the ownership of capital and its place in the theory of distribution.[1]

Sundry classifications of monopoly have been proposed. The simplest, and that which will suffice for such a general survey as is undertaken in this book, is into absolute monopolies on the one hand, and industrial monopolies on the other. Absolute monopolies are those in which, by law or by ownership of all the sources of supply, the holder's control is complete. Industrial monopolies are those in which the control over the supply, while not complete, is yet effective enough to bring a state of things different from that of competition; in which, even though there be no legal or natural restriction, the nature of the operations is such that competition is wholly removed, or operative only to a limited degree.

Where there is an absolute monopoly, the situation is com-

[1] Compare the chapters on Railroads, Combinations, Public Ownership; Book VII, Chapters 60–63.

paratively simple. The general principles involved have been sufficiently stated in the chapter on Monopoly Value.[1] The monopolist, if vigilant and shrewd, will fix that price at which his net profit is greatest.

Copyrights and patents supply the simplest cases of absolute monopoly by law. During the term of the exclusive privilege, the holder is affected by competition only in so far as substitutes are available, — often a considerable limitation, yet by no means such as to prevent very great gains from some patents and copyrights. Among modern patents, those of Bessemer for making steel, of Bell for the telephone, of McKay for the sewing machine used in shoe manufacturing, the Northrop automatic loom, the Mergenthaler linotype machine, the Edison light, have been conspicuous for success. The justification for the gains from such patents is that the prospect of securing them has been a spur to invention, and that, though prices may be above the competitive level during the term of the patent, the public gains in the end. Patents are granted for a limited period, usually for about fifteen years (this is the term in France, Germany, and Austria; in Great Britain it is fourteen years, in the United States seventeen). When they expire, the unrestricted use of the device is expected to bring to the community cheaper or better goods than it would have had otherwise.

The assumption underlying patent laws, namely, that the improvements would not have been made but for the monopoly privilege, in the main is justified. Though some persons are born with an instinct for contrivance, and will be impelled to invention as irresistibly as others will be to literature or science, the prospect of a reward is in most cases an indispensable stimulus. This is the more the case with patents, because they almost always involve considerable risk, both for the inventor and for those who supply capital for working the invention. Of the patents actually taken out, — thousands of them annually in a country like the United States, — the immense

[1] See Book II, Chapter 15.

majority come to nothing. Though most of the failures were certain from the start (all sorts of absurd or insignificant devices are patented), the future of many, involving much thought and labor, is uncertain. They may prove valuable, and may prove worthless. After a patent has been secured and launched, there must often be expensive experimenting with further devices and improvements. For at least two of the inventions just mentioned, — the Northrop loom and the Mergenthaler printing machine, — hundreds of thousands of dollars were spent in preparatory and experimental operations. In other words, risks must be run, and there must be prizes to offset the failures. If every process that had been worked out with much labor and large expenditure were, when perfected, at once open for use to every comer, the original inventors and investors would have much less prospect of reaping a sufficient reward. Here, as elsewhere, occasional windfalls, which may seem out of proportion to the desert of the particular fortune-winner, must be accepted as part of the encouragement of vigor and enterprise.

Much the same can be said of copyrights. It is true that in this case, more than in that of mechanical inventions, the inborn bent of some individuals produces its effect, irrespective of rewards. But literature as well as art shows not only all degrees of merit, but all shades of motive. In the making of most modern books, the stimulus of individual gain plays no small part. Legal protection for the book writer is peculiarly necessary; for a book can be reprinted *verbatim* at once, whereas a new mechanical device may be often shielded from competition for some time even without a patent. Given the principle of reward in proportion to useful activity, then copyright is a natural and consistent application of it; and those who, in the absence of legal protection to authors, print their books without making payment, are not inaptly termed pirates.

Absolute monopolies resting not on legal restriction, but on control of natural resources, are rare. The diamond mines of South Africa, to which reference has already been made, afford

an instance.[1] The owners of the nitrate beds in Chile have affected a combination, and the owners of the world's borax supplies have consolidated into a single corporation. In both of the last-mentioned cases, the natural resources are supposed to be limited; but there is always in the background the possibility of the discovery of new supplies, or of the utilization of others that are known but are of poor quality. Hence the monopoly is not unchecked in its control over supply. The usual situation is that so-called monopolists of this sort are in the possession, not of the sole sources of production, but of the best, and hence that their gains are more in the nature of economic rent than monopoly gains in the narrower sense.

§ 2. Much more important in the modern world are industrial monopolies. These also are rarely quite unfettered; but the limitations on their prices and profits come not so much from the existence of poorer sources of supply as from public regulation and the possibility of competition. Broadly speaking, they are of two sorts,—"public service" industries and the familiar "trusts."

"Public service industries" is a convenient phrase to designate water supply, gas supply, railways and street railways, the telephone and telegraph, electric lighting, and the like. These are operations which affect great numbers of people, which usually call for some special grant of privilege, such as the right of eminent domain or the use of the public highways, and which are best carried on under single management. The last-named characteristic is the important one for our present purpose. The advantages of single management are so great that, even though there be an initial period of competition between two or more establishments, consolidation is certain to ensue. The community may as well accept once for all the fact of monopoly, and regulate its affairs accordingly.

Increasing returns in the strict economic sense are a usual characteristic of these industries. A single great plant can do the work more cheaply as it gets larger and larger. It is a

[1] Book II, Chapter 15, § 2.

wasteful process to duplicate a railway line, the mains of a water or gas system, the wires of a telephone or telegraph system. In the case of telephones and telegraphs there is the further circumstance that all customers are better served if all are connected with a single system. Sometimes, it is true, when the stage of very intensive use is reached, the duplication of a plant may become necessary; there may be need of a second set of main pipes, of duplicated railway tracks or an additional line. Even then, there are almost always appreciable economies in managing the several plants as one; and, whether or no there be such economies, it is certain that so small a number of competitors will form a combination. Chiefly because of increasing returns in production, and in any case because of the small number of possible competitors, the emergence of single control is inevitable.

These industries bring increasing returns in another sense: not merely increasing efficiency of labor, but increasing profits. The growing numbers of the community will commonly make the single plant, or combination of plants, more profitable as the years go on. A traditional price for the product or services is fixed at the outset, which then is usually a "fair" price, — that is, a price such as yields no unusual gains. As time goes on and population increases, expenses per unit decline; and improvements in the arts often cause the expenses to decline still more. But the traditional price remains, competition is absent or only intermittent, and the gains from the undertaking swell. In this gradual growth of gains, due chiefly to the advance of the community at large, there is a strong analogy to the rising rent of land, and especially of urban sites.

Some inventions of modern times have served greatly to increase the gains in such industries. The application of electricity to traction has enormously increased the efficiency of labor in street railways. The improvements in gas manufacture, especially from the use of naphtha in making water gas, have been hardly less important. The growth of cities would in any case have made these industries more lucrative.

Cheapened as their operations have been by great advances in the arts, they have become sometimes fabulously profitable. The essence of the gain has lain in the "franchise," — that is, the exclusive right to carry on the industries in a given city or in the most advantageous streets of a city. It is this foundation of monopoly which has enabled the holders to retain for themselves — not necessarily *in toto*, but in large part — the economies in operation due to growing population and to improvements in the arts.

§ 3. More troublesome problems of economic theory, and no less difficult problems of public policy, are presented by the so-called "trusts"; that is, the great horizontal combinations, under single management, of a series of separate establishments. The difference between the monopoly industries considered in the last section and the trusts lies in the fact that here there are usually a number of physically separate plants. A street railway, a gas system, a telephone and telegraph net, a railway system, — each is a physical unit. But when a dozen sugar refineries, or chemical works, or lead factories, are united in a trust, the separate plants remain separate, though now managed as one.

It must be confessed frankly that we do not know, in the present state of economic inquiry, to what extent effective monopoly is likely to develop in such industries. If there were a general tendency to increasing returns from the mere fact of concentration in ownership and management, we should expect monopoly to develop without fail.[1] Yet even in the absence of such a tendency continuously in operation, some degree of monopoly control may appear. The great combination or trust may keep out rivals by cutthroat competition, by sheer weight and power. On the other hand, large gains do tempt interlopers, and the constantly swelling volume of accumulations in search of investment causes every chance of securing large returns to be sought out. There is the crucial

[1] Compare Book II, Chapter 14, § 3. See also Book VII, Chapter 63, on Trusts and Combinations.

question of management, too; the possibility of nepotism and ossification in the great combination, when once the founders (usually men of exceptional ability) have left the field. New blood may appear in new enterprises, and an apparently secure position of dominance may be lost to a later generation of business leaders. To repeat, we are much in the dark as to the future of this remarkable economic movement, and cannot be certain how far the range of monopolistic control and monopoly profit will extend.

This much, however, is clear: that competition acts more slowly in many directions than was believed by the economists of a generation ago. If not complete monopoly, a quasi-monopoly, enduring for a considerable time, is likely to appear wherever industry is conducted on a very large scale. For an indefinite period something more than ordinary or competitive gains may be secured. Given the constant enlistment of fresh ability of a high order in the management of the great combinations, and the profits may be kept very large by mere force of great size, great capital, great overawing of would-be competitors. There is the possibility, even the probability, of a gain which is in excess of interest and of economic rent, as these have been analyzed in the preceding chapters; in excess, too of "business profits," as this sort of income will be analyzed in the chapters next following; a gain, therefore, which is to be classed as a monopoly return.

§ 4. As the rent of land may be capitalized in the selling price of land, so monopoly gains may be capitalized in the selling price of the monopolized piece of property. This happens nowadays most commonly through the mechanism of corporations and through the "watering" of corporate securities. When a corporation having some sort of monopoly advantage secures high returns, its shares may yield large dividends and may sell at a high premium; or the number of shares may be increased or watered, and the same returns distributed among the owners in the form of lower dividends on a larger number of shares. The total selling value of the shares, whether

of a small number at a high price or of a large number at a moderate price, will represent in either case the capitalization of the net earnings at the current rate of interest on investments.

Vested interests present questions of the same sort in the case of monopolies as in the case of land. Where some kind of exclusive privilege has been expressly granted, and monopoly gains have consequently arisen, the terms of the grant cannot but be observed. Even where there has been no grant for a clearly specified term, but only the long-continued maintenance by the public authorities of settled policy, vested rights are entitled at least to some degree of consideration. Thus, in certain American cities, street railways have no privileges for any stated period of years, and are subject to regulation at will. Yet where they have in fact carried on their operations undisturbed for an indefinite period, and where purchases of securities have been repeatedly and continuously made in the expectation that the *status quo* will be maintained, the holders have a position not very different from those of the landowner who has bought a site in good faith. On the other hand, where such rights have been given for a limited period or in express terms subject to public modification, the investor must be held to have taken his risks. Still more, a future rise in yield and in selling value is clearly open to appropriation by the public.

CHAPTER 46

The Nature and Definition of Capital

§ 1. The gradations of monopoly; the analogies between monopoly gains and rent (in part still to be set forth); the often shadowy line of demarcation between interest and the other incomes from property, — all these suggest the question whether the whole conception of capital and of income from capital does not need revision.

In recent times many economists have questioned the validity of the distinctions drawn in the preceding pages between the different instruments of production and the different sorts of return to their owners. The distinction between land and capital has perhaps been most questioned, and with it the corresponding one between rent and interest. But the distinction between rent and monopoly gains has also been drawn into doubt, and hence that between land and monopolized capital goods. There has been a general disposition to reconsider what should be included under the term "capital," and what is the social significance of the various incomes accruing from the ownership of property.

There are several tenable grounds for regarding all these incomes as homogeneous.

In the first place, no returns are earmarked as monopoly gains or as rent; none are distinguishable at sight from simple interest. When it is said that land "yields" economic rent, the phrase is used elliptically; so also, when it is said that a patent or an industrial monopoly "yields" a monopoly return. What happens is that in proportion to the labor or outlay in preparing and tilling the land, the output is large; and, in the case of monopoly, that the receipts are large in proportion to the expenses of constructing the plant and operating it. In

either case there is an exceptional return, a surplus yield. But this is distinguishable from interest only on the assumption that there is a well-defined nonexceptional return, — one normal for capital subject to unfettered competition. In any concrete case there is always a difficulty in setting apart with precision that return which would be received under competitive conditions from the surplus which would disappear if competition were free.

Further: the divergences from the "normal" return, or simple interest, are many and various. They shade into each other by gradations. All sorts of industries present a differential element; not only the urban site in the heart of a metropolis and the valuable patent monopoly, but the factory established at a "strategical" point and that which has a quasi-monopoly of prestige and trade-mark. There are plenty of industries and plants where for very long periods much more than simple interest is secured. There are others where much less is secured. The older writers often described the industrial situation as presenting a few cases of monopoly, and some other cases of easily distinguished "rent"; and then a great stretch of industries having normal profits. But this does not truthfully represent the extraordinary variety and irregularity of the world as it is.

Again, in view of the diversities in the rates of return, it is reasonable to say that monopoly returns are not separable from economic rent. They do, indeed, present some peculiarities. The essential element of true monopoly, as we have defined it, is control of the supply; and no doubt it is true that so far as a monopolist has this, he is in a different position from the person who has merely a differential advantage in producing a part of the supply. But complete monopoly control is very rare; some sort of competitive or inferior substitute is commonly to be reckoned with. Monopoly gains then may be said to be only a variety of the species "rent." And in any case monopoly gains rest on the fact that the thing monopolized has high serviceability or utility; it yields more

in the way of eventual satisfactions than other things; and hence it may be said to yield a differential return, very much as a good water power or a fertile field yields a differential return. What its owner gets is thus analogous to the "rent" derived from a natural agent.

§ 2. Considerations of this kind have led to a method of approaching the problem of property income very different from that followed in the preceding chapters. It is said, and with undoubted truth, that all concrete instruments of production have a *derived* value. They get their value from the utilities which in the end they bring about or aid in bringing about. The income-yielding power of a cotton mill results from the price of the cotton goods, which in turn rests on the utilities of the goods to consumers. The income-yielding power of a street railway rests on the utilities of rapid transportation; that of a house lot on the agreeableness of dwelling on the site; that of business premises on their convenience for making or distributing commodities. Some of these instruments are more effective in supplying utilities than others, and, in proportion as they are more effective, are more valuable. But all belong to the same class: they are immature utilities, so to speak, and are valuable in proportion to the satisfactions that in the end will ripen.

It is a further development of this train of thought, and a further proposed change in phraseology, to say that every instrument yields a "rent," — a rent not in the older sense, but in quite a new sense. That "rent" is its yield or its income; in the sense in which the possessor of a settled income is styled (on the continent of Europe) a "rentier." It is the net income yield of the instrument, resulting from the utilities which the instrument provides or aids to provide. Whether it be a huge steamship made by much labor or a lucrative city lot, the income of the owner depends on what this concrete thing yields in the way of addition to the ultimate income of the community. The one as well as the other is based on serviceability. The owner's income, it is said, may

be regarded as "rent" or as "interest," according to the point of view. Regarded as a gross amount, it is the rent of the instrument; regarded as a percentage on the property or capital embodied in the ship or the lot, it is interest. Capital being regarded as homogeneous, and as including all the various kinds of instruments, all return from it is homogeneous. The return is regarded in a different light, but is not *per se* different, according as we dub it interest or rent.

Pursuing this train of thought further, we might say,[1] that capital is of two kinds, — artificial and natural. Natural capital is that which has been classed under the general head of "land" or "natural agents"; artificial capital includes all instruments made by man. Natural capital may be highly useful and highly valuable, as in the case of a rich mine or a deep-harbor site. In that case it may be said to contain or embody a great deal of capital. A street railway, or a factory in which a monopolized article is produced, may be said also to contain or embody an exceptional amount of capital. Their valuation is high; their capitalization indicates the existence of a large volume of capital.

Evidently still another question is here involved: how *measure* the amount of capital? The reasoning just stated would measure it in terms of value. And this, too, is the ordinary business method of measurement. A mine, a railway, a parcel of real estate, a factory, each is valued on the basis of its net income; it is capitalized. The distinctions sought to be drawn by economists between interest, rent, and monopoly gains find no response in the world of affairs. There all property is valued in terms of its income; all that brings in an income is alike capital, and all is measured or capitalized on the basis of its income. Those economists who dissent from the older view follow the business community's way of defining and measuring capital. In that older view, on the other hand, the definition of capital as instruments made by man led to its measurement in a very different way, — namely, in terms of

[1] With Professor A. S. Johnson, *Introduction to Economics*, p. 197.

cost, of expense, of labor. As will appear later, these are not precisely equivalent terms;[1] but for the purpose of the present discussion, discrepancies between labor involved and expense incurred may be neglected. In the main, capital was measured, in the older view, in terms of labor involved. Capital meant previous labor or embodied labor; and capital was more or less, not according to its value, but according to the amount of labor involved and the length of time over which that labor was spread. The difference between the older and the newer views is similar to that between a "commercial" and a "physical" valuation of a railway.

Pushed to its last consequences, this valuation principle leads to some results that take one aback. A public debt, say in the form of a French "rente" (that is, a mere promise to pay an annual sum), is capitalized in terms of selling value; and it becomes "capital." A burden on the community is thus included under the term "capital," which yet indicates in general the useful apparatus of the community. A naked patent right or "franchise," not yet attached to a concrete instrument, becomes capital. A perpetual pension, such as the English Parliament used to grant to royal favorites or military heroes, becomes "capital"; it, too, can be measured in terms of value, and capitalized. Nay, a human being, in so far as he is an instrument for production,—and he may be conceivably regarded as such, just as a slave is an asset, — becomes "capital"; and then return to labor, as well as income from property, may be regarded as "interest" or "rente."[2]

From still another point of view, the distinctions between interest and rent and monopoly gains have been discarded,—namely, from the socialist point of view. To the socialist the difference is simply between tweedledum and tweedledee. All these incomes are unnecessary and unjustified. All result from a bad social system, and should be abolished. And it is

[1] See below in this Book, Chapter 48.

[2] This extreme application of the reasoning is made by Professor I. Fisher, *Elements of Economic Science*, Chapter XXIV, § 1. Compare J. B. Clark, *Distribution of Wealth*, Chapter XXII.

true that all are alike in that they make possible the leisure class. This last is the phenomenon in existing society which, when once privilege is no longer regarded as part of the order of nature, most calls for explanation. Why should a considerable number of able-bodied persons live in idleness and plenty? That the aged and infirm, the children and even the women (at least the married women), should not be engaged in the ordinary productive occupations, seems proper enough; but why should healthy adult men not labor to contribute to the general welfare of society? In the feudal system, the privileged classes were at least called on to render military service. In our own society, they are called on for no service at all. Is this inevitable? Is it just? Is not this question the same for all of the leisure class, and for all of their incomes? Do they not all own "capital," and all alike secure a capitalist income?

§ 3. Two important questions underlie these matters of definition and phraseology. One is a question of taxonomy, of cold classification: are there sufficient differences between the various sorts of income from property to make reasonable different names for the incomes and for the kinds of property? The other is a question of large social import: are there grounds for applying a different public policy to the various sorts of income? Both questions, as it happens, turn in the end on the same point: is there effectiveness of competition as to capital (artificial capital), and is there a normal competitive return usually secured from investment and needful in order to induce investment?

It is clear that there is not effectiveness of competition or equalization of return as to "natural capital," — land and natural agents. The better among these agents yield more than those less good. So far as there is similar ineffectiveness of competition, and similar inequality in return, among the instruments made by man, their yield presents no phenomena essentially different from those of natural agents. But if there be effective competition between the various forms of artificial

capital, no one among them will in the long run bring to its owner an exceptional or differential return; then there is interest, and interest only, on capital in the narrower sense; and then there is a substantial difference between "interest" and "economic rent.

On this matter of the actual efficacy of competition, we must speak with reserve. In some directions it is clear that the older notion of full competition between all forms of artificial capital must be given up. There are industries in which large-scale operations and increasing returns lead inevitably to monopoly, — such as many of the so-called public service industries, — and in which the return is in so far analogous to economic rent in the older sense. There are the trusts and quasi-monopolies in which similar variation from a supposed normal return is found. And even in industries outside the pale of monopoly or combination, there are extraordinary variations in the returns got by the owners of factories, warehouses, ships; so that there seems ground for rejecting the whole supposition of equalization in yield from artificial capital, and so for rejecting all distinction between rent and interest.

Yet in the long run, for probably the greater quantity of "artificial capital," the matter takes a different aspect. Though the competitive régime has broken down over a considerable range of industries, it has not yet ceased to be the prevailing régime. Though there are great variations in the returns secured by the owners of almost any form of concrete capital, these are mainly explicable, as will presently appear,[1] from differences in the business capacities of the owners. Setting aside the differences so explained, and those due to the irregularities of demand; having regard to the slowness with which new plant can be made, and the even greater slowness with which old plant wears out; looking at the long-run results, — we find that there is after all a tendency to equalization over a large part, probably the larger part, of the industrial field. If a particular kind of artificial capital proves exceptionally profit-

[1] See below, Chapter 49.

able, more of that kind will be made, and the return on it will be lowered. In this probability lies the essential ground for distinction between capital and land, interest and rent, competitive gains and monopoly gains. If the return on every specific kind of concrete instrument were a mere matter of accident, or at least were not amenable to any competitive or equalizing influence, — then all alike would be mere "rent" yielders, and would have a value resting once for all on the utilities provided through them. The conditions of demand alone would govern. But the conditions of supply affect the larger part of the concrete instruments. Only a part are limited natural agents, or are shielded from competition by a monopoly position. Hence we can speak of a normal return, or interest, in the one case, and of rent and monopoly gains in the other cases.

The same conclusion can be stated in another way: there is a broad *margin* at which the return to capital is settled, — settled at that normal rate which in the long run suffices to induce saving and accumulation. Other gains to the owners of concrete instruments are measured by the excess above what is got at the margin. These extra gains are in some respects similar to economic rent, in some respects different. Their extent and variety is much greater than was supposed by the economists who first worked out the principle of rent, and they have a great effect on the distribution of wealth. But so long as the broad competitive margin persists, they leave unaffected the distinction between the normal or "earned" return on capital, and the excessive or "unearned" return.

In answering our first question, the taxonomic one, we have by implication answered the second, also. Interest on artificial capital, as settled under competitive conditions, presents different social problems from those presented by the rent of natural agents or by monopoly gains. The one is an inevitable part of the régime of private property;[1] the others are not, or at least are inevitable only in so far as vested interests must

[1] Compare also what is said below in this Book, Chapter 54.

be respected or as the exact line between interest and surplus returns proves impossible to draw. Economic rent and monopoly gains are unearned returns, and should be treated differently from return on capital pure and simple. This is indeed admitted by the economists who are disposed to treat all "capital" as homogeneous. When it comes to problems of legislation, — of taxation, for example, or matters of public regulation, — they agree that the various capitalistic incomes should be dealt with differently: those from the better natural agents or monopoly industries should be curbed; those from competitive capital should in the main be allowed to go their way.[1] The socialists, on the other hand, hold that these sorts of income are alike unnecessary and unjustified, and alike should be swept away. It is from this point of view, at all events, that the question of classification and nomenclature is most important. Economics is in a special sense a pragmatic subject. Its truths are eminently truths in the sense that they concern us. Its answers are answers that declare what we should do. As to any question of classification and distinction, the test of truth is, what of it? what follows? In economics the consequences that follow are ultimately consequences for general welfare and public regulation. So considered, the question whether income-yielding property is homogeneous, and all the sorts of income essentially of the same sort, is to be answered in the negative.

[1] In the main; compare Book VIII, Chapter 66, § 5.

CHAPTER 47

DIFFERENCES OF WAGES. SOCIAL STRATIFICATION

§ 1. Wages are commonly thought of as a separate and clearly distinguished form of remuneration, appearing when one man is hired to work for another. Very often they are part of a mixed or combined return, as when a farmer owns his land and capital, and gets rent and interest in addition to a return for his labor. In almost every case where a worker is not hired by another, — a physician or lawyer, or artisan working on his own account, — there is some combination of returns. The theory of wages should consider the remuneration of every sort of labor, that constituting a part of the complex earnings of such independent workmen as well as that constituting the sole earnings of a hired laborer. But most of the problems are sufficiently dealt with by an examination of the case of hired laborers, with incidental consideration of those not hired.

Though it would appear logical to examine first the causes which act on the general rate of wages, the way is cleared by taking up first the causes of differences in the earnings of various sorts of labor and some other topics closely connected with those differences. The theory of general wages is reserved for treatment at the very last.

Differences of wages may be classed under two heads, — those that equalize the attractiveness of occupations, and those that persist irrespective of their varying attractiveness. If choice between occupations were perfectly free, only differences of the former sort would exist. We may begin with these, which may be called equalizing differences.

If choice were free, an agreeable occupation would command a lower rate of pay than one not agreeable. Something would

need to be given, in the way of premium, to offset unattractiveness. As between occupations of similar grade, open to persons of the same class, we find differences that are explicable on this principle. A woman or girl working in a factory or shop receives in the United States a lower rate of pay than a domestic servant. Though the payment in money to both is often very nearly the same, the servant receives in addition her food and lodging, and her total remuneration is very much higher. The main explanation is that in a democratic community domestic service is repugnant; it has the associations of a menial position. The shop girl often has longer hours and harder work. But her work is of a more impersonal sort, and her hours are strictly defined. When the day's work is done, she is her own mistress. In European countries, where the spirit of freedom and the yearning for equality are less awakened than in the United States, considerations of this sort count for much less; and domestic service there receives no such comparatively high wages. American housekeepers of the well-to-do class complain of the scarcity and the high wages of servants, usually without an inkling that these are the results of the spirit of democracy.

In another range of occupations, the principle is illustrated by the pay of university teachers. Much has been said of late years in this country of the low range of professors' salaries. Very possibly it is true that, as compared with earnings in other occupations of the same grade, and for persons of the same training and ability, the range has been low, — so low as to make the occupation less attractive than it should be to able men. But the calling has great charms. The respect which it enjoys, the settled and moderate routine, the pleasure of intellectual interest and achievement, the long vacation, — these make it attractive, even with pay less than that of competing occupations.

Peace of mind and industrial security are valued by most people; hence governments and large corporations, able to promise continuous employment, can secure their employees

at comparatively low wages. Where, indeed, public business is not managed on strictly fiscal principles, this consequence does not show itself. In most democratic communities, and especially in the newer ones, like the United States and Australia, the government is expected to pay more than the private employer, irrespective of the steadiness and attractiveness of its work. The great bulk of the workmen, though they are not in government employ, approve of the favored position of those who are; partly because of general class sympathy, partly because of ignorance of the economic effects. Nothing is more certain than that higher wages to public employees come out of the pockets of the rest of the community. But such wages are none the less welcomed by other employees, because of a notion that they have an uplifting effect on wages at large.

§ 2. Irregularity of employment, on the other hand, may be expected, so far as competition is free, to make wages higher. It is said that bricklayers receive higher wages than carpenters, largely from this cause; their work being more likely to be interrupted by the weather and the seasons. So far as the higher pay per day or per hour simply offsets the smaller time actually given to work, there is here no difference in the total remuneration. But if the greater uncertainty makes the occupation unattractive to most men, it will cause the total remuneration to be higher. Unfortunately, most manual workmen have not the foresight and intelligence necessary for discounting wages which seem high but are uncertain. It may be doubted whether irregular or hazardous work usually yields wages strictly in proportion to its actuarial worth.

This same undervaluation of risk shows itself in the attractiveness of occupations in which there are prizes. The law is a profession in which there are great possibilities, — the chance of a handsome income, and, not least, the glittering possibility of success and fame in those public posts to which the law is the natural pathway. Hence, notwithstanding the need of an expensive training and the certainty of a slow rise to full earning power, it draws more men of promise and capacity than any

other of the learned professions. Again, the training of an opera singer is highly elaborate and costly, and also involves a large possibility of complete failure. Yet the great prizes — the extraordinary fees of the notable few, and their conspicuous though short-lived fame — attract so many that for the occupation as a whole there is probably but a very moderate return.

An occupation which calls for a prolonged and expensive training will have, *ceteris paribus*, a relatively high reward. Physicians, engineers, teachers, lawyers, must equip themselves by years of study, and ordinarily must serve some sort of apprenticeship even after the period of set study has been passed. It is obvious that people will not incur the required outlay unless there is a prospect of earnings at least in some degree commensurate. No doubt this factor operates in combination with others; and there is great irregularity in the final outcome. Not only do prizes in an occupation affect the resort to it, and lead people to undertake a costly preparation without a cool-headed calculation of the chances of success; but parents, through whom the decision to enter on a prolonged training is commonly made, are not solely actuated by mere calculations of gain, nor are they the best judges of the probabilities of gain. Their first wish is generally to provide for their children greater happiness in life, and they will often pay for an elaborate education chiefly for the sake of supposed social advantages. Often they do not weigh with impartiality the question whether their children have the inborn qualities to profit by such an education. On the other hand, any occupation which requires expensive training is by that fact closed to the immense majority of the people, — a circumstance which, as will presently be explained, is of at least as much importance as any other in explaining the effects of education and training on variations in wages.

§ 3. It requires but the most cursory observation to show that such explanations of the variations in wages as have just been given do not tell the whole story. The broad fact is that the attractive and easy employments do not in general com-

mand the lowest pay. It is more nearly true that they command the highest pay. The common laborer or the miner receives less for his hard, dirty work than the skilled workman for his lighter and cleaner work; and this, though the latter's hours are usually the shorter, and his employment no more irregular. The work of the lawyer, the physician, the business man, is easier as well as intrinsically more interesting, more varied, more attractive, than that of most sorts of manual laborers. Yet, even after due allowance is made for the expensive training called for by these so-called "liberal" professions, their earnings are large as compared with the sacrifices they involve.

This discrepancy between sacrifice (work) and reward could not exist if choice between occupations were free. The day laborer would be glad to become a mechanic or engineer, or to advance his children to those more attractive occupations, if the choice were open to him. The obstacles are in some small degree due to a quasi-monopoly in certain occupations; but in the main they are based on the great fact of long-established social stratification.

Set monopoly of any sort is becoming less and less important in the modern world. Legal monopolies, such as those of the craft gilds of the Middle Ages, have disappeared. Something analogous to craft monopoly is occasionally aimed at by trade unions, admission to a union being restricted by high fees or by limitation of members, and employment permitted, so far as the power of the union extends, to members only. In some trades which retain the handicraft character, and in which skill can be acquired only through careful instruction and long practise, such restrictions have sometimes proved effective. But in most industries the machine tends to displace the tool. General ability rather than specialized skill is required for attaining mastery; no small knot of mechanics can keep under their control the art of doing any one kind of work. Attempted labor monopolies have usually broken down.[1]

[1] Compare Book VI, Chapter 55, § 3.

The permanently important forces are not those intentionally set in motion by any group of workmen, but the varied influences, direct and indirect, obvious and obscure, which set up barriers between the different classes of society. They may be considered under three heads: expense of education and training; the subtle influence of environment; and, finally, differences in inborn gifts.

§ 4. Expense of education, as we have already noted, would bring about, even under free competition, higher wages. This is most obviously the case where the parents or the young persons themselves pay for the training. It is so, even if the training is supplied gratuitously in public schools and colleges; for, though instruction itself be gratuitous, support must be provided. Only if the state were to supply education of every kind on the terms which it grants in the United States for the army and navy cadets at West Point and Annapolis, would the burdens which education entails be taken entirely from the individual's shoulders. As things stand, this burden is not only heavy, but it is one which, as it becomes heavier, the poorer members of the community can less and less undertake to bear. When the day laborer's child reaches the age of thirteen or fourteen (often even earlier) the increasing expense of support, and the possibility of some earnings, cause him to be taken from school and set to work. Only rare conditions — great altruism and persistence on the part of parents, evidence of exceptional ability in the child, charitable aid — enable him to go beyond the elementary school. The gateway to a more advanced education is virtually closed. The child of the mechanic and clerk goes a little farther in his schooling, and is more likely to find his way into the secondary school. Even so, the completion of the secondary school curriculum is unusual; the path forward is cleared but a little way. As a rule, only those who themselves have enjoyed a higher education and its fruits provide for its completion by their children also. Hence differences in reward, and the social classes which rest mainly on them, tend to perpetuate themselves. The very fact that

a man has had an advanced education tends to secure it for his children. The very fact that a laborer has not had it is an almost insuperable barrier to his children's securing it.

Expense of education thus affects differences of wages doubly. It affects them, through the working of competition, in lifting rewards to a level at least high enough to make the expense worth while. It affects them also through the restriction of competition, by impeding access to the better places for multitudes who, were they able, would gladly seek it.

Environment, the second among the barriers to free movement, cannot be sharply separated from education and training. To the factor of expense in education, it adds another that keeps potential competitors from trying to enter the more favored ranks. All the associations of nurture and family, all the force of example and imitation, keep a youth in the range of occupations to which his parents belong. In a highly mobile and democratic community like the United States, environment tells less than in older countries. But it tells much in all countries. The gifted and alert may feel ambition to rise, but the mass accept the conditions to which they are habituated.

§ 5. Finally, we have to consider differences of inborn gifts; undoubtedly great and of far-reaching effect, yet, in their influence on the broad phenomena of social stratification, not fully understood. Some fundamental questions relating to this topic still await positive answers.

In the eighteenth century, the common belief was that men were endowed by nature with the same mental and moral gifts. "The difference between the most dissimilar characters, between a philosopher and a common street porter, seems to arise not so much from nature, as from habit, custom, education." [1] Rousseau believed that with proper education he could shape men's capacities at will; and Robert Owen rested his optimistic social experiments on the belief that, given favoring conditions, all men would prove equally industrious and equally virtuous.

[1] So said Adam Smith; *Wealth of Nations*, Book I, Chapter II, p. 17, Cannan's edition.

During the nineteenth century the effect of biological investigation, under the leadership of Darwin, was to turn opinion the other way. It laid stress on the inborn differences between individuals of the same species, the transmission of variations from ancestor to descendant, the close association of physical and mental traits. A possible corollary was that the better position of the more favored classes resulted, in part at least, from inborn qualities transmitted from generation to generation. In recent years, more and more attention has been given to the bearing of such reasoning upon social phenomena, with the result that no positive proof or disproof has been given as to the part which natural endowment plays in separating social classes.

Some differences in remuneration and in consequent social station are certainly due to inborn gifts. Within any one grade in society, still more certainly within any one profession, some individuals have exceptional capacity and thereby gain exceptional rewards. There are lawyers, physicians, scholars, poets, inventors, business men, whom nature endowed with rare qualities. Education may aid them, environment may hamper, but innate capacity proves decisive. The influence of heredity is often traceable; yet the degree to which a given talent or combination of talents is developed seems subject to no ascertainable law. The fact of varying endowment, whether in the way of genius or of high talent, is as unmistakeable as its causes are inscrutable. And from this fact it follows that some individuals earn more than others, and that some differences in wages, under a régime of competition, are inevitable.

The more difficult question is whether there are broad differences in gifts of mind and character among the several social classes. More particularly, are the well-to-do possessed, on the whole, of qualities not possessed by the manual laborers? If we were to go back to the very beginnings of social differences, we should doubtless find that those who first swung themselves into favored positions did so by virtue of natural

gifts. The earliest savage chiefs rose to command because of superior strength or cunning. The feudal lords were at the outset the natural leaders of the clans. The city merchants in whom we find the origin of the bourgeoisie were the shrewd and capable men of their towns. The analogies of heredity suggest that the qualities of such ancestors were transmitted to their descendants, and that the so-called higher classes of modern times constitute a born aristocracy. Though heredity is irregular in its individual manifestations, for large numbers it shows regularity and persistence. Take a thousand children of gifted parents, and a thousand children of mediocre parents; the former will prove a superior class, even though a sporadic genius may emerge among the latter. Can it not be inferred that the broad differences between social classes rest on differences in their inherent intellectual and moral endowments?

Farther, it is maintained that the distribution of success in life proves the greater average gifts of the higher classes. Statistics concerning the notable men of several countries (especially England and France) show that the aristocracy, the well-to-do classes and the town dwellers, have furnished the immense majority of the men of mark, — the writers, statesmen, soldiers, industrial leaders. In proportion to their numbers, talent, as indicated by achievement, has been vastly more abundant. Even genius has been recruited chiefly from their ranks. Such evidence is adduced as strengthening the view that inborn gifts vary with social classes.

On the other hand, it is contended that this very evidence shows the commanding influence of opportunity and environment. Any one of intellectual capacity who consorts with the average persons of the "superior" classes, and observes their narrowness, their dullness, their fatuous self-content, their essential vulgarity, must hesitate before believing that they and their descendants achieve success solely because of unusual gifts. Their favored position must be due, in large measure at least, to training, advantageous start, fostering environment. If few from among the lower classes rise, it must be

because of the repression of many who are talented. Only those of very unusual vigor and ability can escape from the trammels. A great fund of capacity, no less in its possibilities than that which is found among the well-to-do, is believed to remain undeveloped. Though variations between individuals are unmistakeable, variations between classes are declared to be unproved.

To this it is added that any higher or favored class tends not so much to transmit to descendants the qualities by which the ancestors achieved success, as to become itself enervated and weakened by continuance in privilege. The later generations of the stock deteriorate. It is only by the infusion of fresh blood from below that vitality and strength are preserved. Such is said to be the lesson of history as to royal and noble houses; such is perhaps the tendency among the successful bourgeoisie. When the conditions of life are made easy, and the struggle for advancement becomes less strenuous, the unfit are no longer eliminated, and the moderately capable are enabled to hold their own. Though conspicuous success continues to be attained only by those of unusual gifts (whether born in the lower classes or among the well-to-do), the advantages of an easy start and constant support still enable persons of mediocre quality to remain in the favored class from which they sprang and to maintain their favored position.

The problem is unsolved, and is likely long to remain so. The method of experiment cannot be applied to it, as indeed it cannot be, in an accurate way, to social problems of any sort. We cannot take a thousand children of the more favored classes, and another thousand of the less favored, subject them to precisely the same influences of education and environment, and watch their careers through life. Still less can we do so with successive generations of their descendants. The method of observation alone is available; one hampered not only by the limitations of the evidence and the complexity of the data, but by the prejudices of those who conduct the observations. Though the analogies from biology (where experiment in the strict

sense is applicable) strengthen the view that inheritance is all-pervading, the plain facts of everyday life prove that opportunity and environment are of signal importance. Those of inborn gifts make them tell with immensely greater ease if they have the advantages of education and training, and of support during the early stages of their career. Those of the very highest gifts are doubtless least dependent on adventitious aid. Generals probably are born, not made. But colonels and captains can be trained. In the ranks there may be many men who have it in them to become good officers, yet are kept in the ranks because no way is available for bringing out the sterling qualities which they possess.

§ 6. At all events, whether from natural causes or as the result of existing social conditions, the movement of laborer from grade to grade is not free. Amid the great variety of occupations and of wages which in fact exists, certain broad groups may be distinguished. These may be called, in the phrase introduced by Cairnes, non-competing groups; non-competing in the sense that those born or placed in a given grade or group usually remain there, and do not compete with those in other groups. For most men it is very difficult, for many it is impossible, to move from the group in which they find themselves into one more favored. We may enumerate, for simplicity and convenience of exposition, five such groups. They are not distinguished by sharp demarcation, for they shade one into another by continuous gradations; but they are distinguished sufficiently to bring into relief some important questions as to the relations between social classes and the fundamental causes acting on distribution and on value.

(1) In the lowest group belong the day laborers, so called: the diggers and delvers who have nothing to offer but their bodily strength. No doubt, among these, there are some gradations. The very capacity and willingness to labor continuously, even at the simplest tasks, through, nine, ten, eleven hours a day, are not possessed by all men, still less by all races, and mark something beyond the quite unskilled grade of com-

mon labor. But labor of this sort is common enough. Almost any adult is able to do the work. For this group, even in the most advanced countries, education is rarely carried beyond the minimum which the law requires. Children are set to work at the earliest age at which they can earn something. The maximum wages of any individual are earned as soon as he is full grown, and become less rather than greater as middle age is reached.

In the same group belong those factory employees whose work is of the simplest sort. In every factory there is a certain amount of "heavy work" to be done, for which the common laborer is needed. In agriculture, there is always a sharp demand for such labor at harvest time, and some demand for it throughout the year; though the planning and direction of farm work calls for much more than simple muscular effort.

(2) In the next group belong those who, while not needing specialized skill, yet bear some responsibility, and must have some alertness of mind. Such, for example, are motormen on the street railways. Most miners belong here, certainly in England and in Germany. In the United States, there has indeed been a tendency (except where machinery is used under ground) to put coal mining into the hands of unskilled workers. The development of machinery and of large-scale establishments has created a demand for an immense number of factory workers whose tasks are comparatively simple, and often are desperately monotonous, but who yet must have some intelligence in watching and applying machinery. Wages in this group are commonly paid by the week, not by the day; a circumstance marking a greater continuity of employment which in itself constitutes a considerable advance over the situation of the first group.

(3) In the third group belong the aristocracy of the manual laboring class: the skilled workmen. Such are carpenters, bricklayers, plumbers, machinists; the whole range of occupations where there is need for a sure eye, familiarity with tools, a deft and trained hand. Though machine processes have

displaced in large degree the handicrafts, the workman skilled at a trade is still in many directions indispensable. Further, the development of machinery has itself called for a great class of workmen capable of making, repairing, and adapting machines. Specialized skill at a particular trade may be less certain to command as high a reward as in former days, because so largely threatened by competition from the machines; but general mechanical ability is in constantly growing demand. It is among workmen who possess such ability that trade unions are strongest. Some accumulation of property is possible, by deposit in the savings banks or by ownership of a dwelling. Some pride in the occupation is developed, and a strong spirit of independence. Education, too, is carried further than in the lower classes. The children are usually put through the entire curriculum of the elementary (grammar) school, and are prepared by apprenticeship or otherwise for a particular trade.

(4) Next comes the group that approaches the well-to-do; the lower middle class, which avoids rough and dirty work, and aims at some sort of clerical or semi-intellectual occupation. Here are clerks, bookkeepers, salesmen, small tradesmen, railway conductors, foremen, superintendents, teachers of the lower grades. Education in this group is carried further; for parents are more ready and better able to support children through a long period. The secondary school (high school or academy) is usually entered, and very often attended through its entire course. Marriage takes place at a somewhat later age; and some endeavor at saving or accumulation is almost always made. There is commonly a feeling of contempt for the manual laborers of all sorts, whether skilled or unskilled, and a demarcation of social feeling that does not correspond to differences in wages; for the rate of pay in this fourth class is, in modern communities, often little different from that in the third class.

(5) Finally, we reach the class of the well-to-do; those who regard themselves as the highest class, and certainly are the most favored class. Here are the professions, so-called, — the

lawyers, physicians, clergymen; teachers of the higher grades; salaried officials, public and private, in positions of responsibility and power; not least, the class of business men and managers of industry, who form in democratic communities the backbone of the whole group. The associations are with property and accumulation, and the common aim is not merely to procure a suitable support, but to save money or to make money. Education is carried to the highest level, commonly through the secondary school, often through the college or university. Earning power does not begin early. Not only is there a long period of training and education, but an additional stage of slow start and slender beginnings; while an increase of earning power through life, or at least through middle age, is confidently expected. Marriage is delayed until late, — often too late for full happiness. The wives are largely ornamental; they are not expected to do household work, or even to undertake the full care of their children, but are given the aid of servants.

The first three groups, including the manual laborers of all kinds, constitute a class by themselves, not only because the gradations of wages are continuous, but because their members have the same point of view and the same prejudices. They expect usually to live on their wages, not looking to the accumulation of property or to an income derived from property. There is a common sense of dependence on manual labor, and a common sense of separation from the well-to-do and possessing classes. The last two groups have similar feelings of solidarity. Even though there are great variations in possessions and income among them, they all have the habits and hopes and prejudices of the well-to-do. They share a feeling that manual labor is beneath them, and their garb indicates their freedom from it, — no jumpers or overalls. Their hope is for accumulation and investment, and their ambition is primarily for swinging themselves into the position of the leisure class. Business — that is, the management and direction of industry, and work that is close to such management — is the core of their doings. We may thus divide the workers into the two

great classes of the soft handed and the hard handed. Those who do not labor at all, — the owners of property yielding income, — belong in the strict economic sense in a group by themselves: their income is not wages of any sort, but interest or rent or monopoly gain. But in a larger sense, they are in the same class as the upper groups of the wage-earners, and especially with the highest and most favored group, sharing the same traditions, and, not least, intermarrying with the members of that group.

§ 7. In modern times and especially in democratic communities, the barriers which separate the groups tend to be broken down, and passage from one to another becomes more easy. We may consider first how those changes affect the lowest group, that of common laborers.

There always has been, and there always will be, much hard, dirty, common work to do; and there always has been, and always will be, a desire on the part of the powerful or favored social classes to get others to do this work for them. Hence slavery in ancient times, and serfdom in the Middle Ages. In modern times, we have negro slavery, Chinese and coolie labor, unskilled common labor. For such there is an insistent demand, for building railways, digging sewers, handling the crops, delving in the mines, — all the tasks for which simple muscular energy is needed. Here are the helots of society. As to them, it is far from being true that unattractiveness in an occupation causes wages to be high. The reverse is more nearly true. The hardest, dirtiest, least attractive work gets the lowest pay.

Evidently, in a free society, the explanation of the low wages of this group must be that there are very many persons who can do such work and can do no other. Their offer of abundant labor forces wages down, and they are prevented from making their way to the more favored groups by the obstacles of environment and lack of training, or by deficiency of inborn qualities. So far as these obstacles are absent or are weakened, there will be a constant endeavor to get out of the lowest group; hence a constant seepage into the groups above,

and a tendency toward equalization of wages. This movement for escape from the lowest group is strong in the United States. All the influences of a democratic society — the absence of rigid class distinctions, the atmosphere of freedom, the education of the public schools — tend to break down the barriers between groups. The position of common laborers in the United States (that is, in the Northern and Western states) has been kept at its low level only by the continued inflow of immigrants. Those of the second generation among the foreign-born usually swing themselves into the second and third groups. The public schools, both by the direct effect of their training and (still more) by their indirect effect in breaking the thralls of environment, open the way to something better. But during half a century and more, ever fresh streams of immigrants have brought new supplies of common laborers, taking the places left vacant as the children of their predecessors have made their way into the higher groups. First came the Irish, whose great movement set in after the Irish famine of 1846; then the French Canadians; latterly the Italians, Hungarians, Poles, and the varied races of eastern Europe. These constant new arrivals have kept down the wages of the lowest group, and have accentuated also the lines of social demarcation between this group and others.

A rate of pay for common laborers much lower than that for other laborers is assumed by most people to be part of the order of nature. But it is by no means a matter of course; and it is very much a matter for regret. Freedom in the choice of occupations is one of the most important conditions of happiness, and the traditional position of common labor is due to the absence of such freedom. The disparities in earnings and in social position of which this is the most glaring are not consistent with the ideals that are dominating the civilized world. They are most of all inconsistent with the aspirations of democracy. It is probable that, even with the removal of all artificial barriers to free movement, common labor would still remain, as its present name implies, the most

common and the least paid. But such great discrepancies as the world has hitherto accepted as a matter of course are not inevitable. They bring grave social dangers, in the intensification of class prejudices and class struggles. They bring a false attitude in the rest of the community toward all manual labor, — an unworthy contempt for indispensable work. An elevation of this group to a plane of higher pay and better social regard would indeed mean that other groups would be relatively worse off, — they would no longer secure the fruits of hard labor on cheap terms; but it would mean a better distribution of happiness.

It is on grounds of this sort that the exclusion of Chinese from the United States is to be justified. Such labor as theirs was much "needed" on the Pacific Coast in earlier days, — "needed" in the sense that there were very few who could be got to do it for the wages deemed by tradition adequate for the work. On strictly economic grounds it was advantageous to the rest of the community. But a permanent group of helots is not a healthy constituent of a democratic society. It is on the same grounds that the position of the negro in the Southern states is matter for grave anxiety. His indefinite continuance as a semi-servile laborer is not consistent with high social ideals; yet his freedom to move (so far as his innate qualities permit) into better conditions is resisted not only by the selfishness of other groups, but by all the strength of bitter race prejudice. The question of the restriction of immigration into the United States is to be decided chiefly, in my judgment, from this same point of view. If immigration means the perpetuation of a low economic and social stratum, it should be restricted. But if those who come in are transformed in due time — their children, if not themselves — into free and mobile members of the community, the country may accept them with little misgiving. The immigrants themselves certainly gain from the very beginning, by finding better conditions and better pay than in their native countries; they do hard work on cheap terms for the rest of the community; and their stag-

nation in the lowest group may be condoned if it is but a temporary stage.

The spread of education and the breaking of the shackles of environment, which make it easier for the lowest group to rise, have had their effects on the relations of other groups also. Clerks, salesmen, and the like, were formerly shielded in some measure from competition, and so maintained in a favored position, by the difficulty of getting the book learning (simple though it may be) which their calling requires. The public school, and especially the public high school, have changed all this. There is a plethora of persons qualified to do such work, and a consequent tendency for their wages to fall rather than to rise. The earnings of a good mechanic are in the United States higher than those of the average clerk. None the less, the resort to the clerk's trade shows no sign of abating. This is due in good part to its association with the management of business, and to the possibility of advancement to a post of command, — the alluring though deceptive chance of a prize. But it is due chiefly to a traditional contempt for manual labor. The externals of the leisure classes are aped. This conventional and irrational feeling against "dirty work" is indeed likely to give way as the pecuniary advantage of the mechanics' group becomes more pronounced and more familiar. In time, people adjust their notions of social superiority to earnings. Any occupation that pays well is likely in the end to be respected, just as any person (or family) having a sufficient fortune is likely in the end to be accepted by the so-called upper classes. But such changes in the conventional hierarchy of society take place but slowly The esteem in which an occupation is for the time being held is a powerful part of its attractions; and the more open is competition, the more will people move into those occupations which are supposed to bring social superiority.

§ 8. What would be the differences in wages, and to how great an extent would groups and classes persist, if all had the same opportunities, and if choice of occupation were in so far

perfectly free? Would wages then differ only so far as they might be affected by attractiveness, risk, and other causes of equalizing variations? Would coarse manual labor, for instance, then receive a reward nearly as high as any other labor, nay conceivably (since the work is dirty and disagreeable) higher than any other? Would the soft-handed occupations lose entirely the advantage in pay which they now commonly have?

The answer must depend on our view as to the limitation of natural abilities. It is clear that some gifted individuals,—a few men of science and letters, inventors and engineers, business men and lawyers, physicians and surgeons,—would tower above their fellows, and would obtain, in a competitive society, unusual rewards. But would physicians as a class secure higher rewards than mechanics as a class? They would do so only if the faculties which a capable physician must possess are found among mankind in limited degree. And mechanics, in turn, would receive wages higher than those of day laborers only if it proved that but a limited number possessed the qualities needed. On this crucial point, to repeat, we are unable to pronounce with certainty. What are the relative effects of nature and of nurture in bringing about the phenomena of social stratification, we cannot say.

One thing, however, is clear: it is much to be desired that this fundamental question be put to the test. The removal of all artificial barriers to choice of occupation is the most important goal for society. Given this, the innate faculties of all will be brought to bear, and all will bring to the social dividend whatever it is in them to contribute; while at the same time the most perfect freedom will be secured, and thereby probably the most even distribution of happiness.

§ 9. The wages of women are lower, as a rule, than those of men. This is due to a variety of causes.

Partly it is due to their lower physical strength and less general efficiency. They are in many sorts of work less productive than men, and therefore paid less highly,—an instance

of inevitable differences in wages, such as would persist even if choice of occupations were entirely free.[1]

In some degree, choice of occupations is not entirely free for women. Custom and lack of training long have shut them out from some occupations. But in modern times, and especially in a country like the United States, obstacles of this sort are becoming steadily less, and probably have no longer any far-reaching effect. Education for women is widespread and accessible, and tradition does not stand obstinately in their way for any occupation for which they are really qualified. Some women, indeed, may be said to be in a non-competing group, having an unfortunate place within the occupations of their own sex. Such are needlewomen, able to do this familiar work of their sex and unable to do anything else. Not so very long ago, such work held the same place for women that common day labor does for men. It was the one thing every woman could do, and the only thing that most women could turn to when they had to earn their living. But the range of available occupations has greatly widened during the last generation or two, and there is less congestion of work-seeking women in any one corner.

Most important of all, in the modern competition of women for work, is the circumstance that as a rule they have to support themselves only, and often not even that. Most women employed in factories or shops are at work for but a limited time, looking forward to marriage. They live in their homes, and their earnings are part of the family earnings. They are "subsidized." Not a few married women are subsidized in the same sense; they earn extra pennies. For a man, wages must

[1] To cite one item of characteristic testimony: among the shirt-waist workers of New York "the testimony of both employers and employees was unanimous that if a man and a woman, who had worked the same number of years at the trade, sat side by side at the same machines, and had been paid precisely the same rate per piece, the man would earn anywhere from 25 to 75 per cent more than the woman. The explanations were that a man worked faster, was stronger and more enduring; that women couldn't do the higher parts of the work; that a man works harder and faster and longer because he has to, has a family to support, 'while a girl is only working until she gets married.'" Mr. Woods Hutchinson in *The Survey*, January 22, 1910.

normally be enough to enable a family to be supported and reared. The great majority of working women are not in this case. Hence they are willing to work for wages less than would suffice to maintain a family; and there being many of them, they must offer their services on terms that will secure the employment of all. Some among them, it is true, do have to support a family, — widows, elder sisters, and the like; and these must accept the same wages as the rest. Conversely, among men, bachelors get the same wages as fathers of families. Such disparities between needs and earnings are the inevitable outcome of competitive industry.

Since women work for lower wages than men, it might be expected that they would displace the men wherever they could do the work. So far as the women are really as efficient as men, this result ensues; in such occupations, for example, as typewriting, stenographing, light factory work, much selling over the counter in retail shops. The men who formerly did this work must find something else to do; and though the shift is not often easy or quick, it usually takes place in the end without serious loss. Sometimes, however, while women displace men in part, they cannot do so entirely. A certain proportion of men must often be maintained. Thus in the composing room of printing establishments, women can do much of the work as well as the men; they can operate some of the typesetting machines as well, and can set most type as well. But for the heavier or more exacting work, men must be kept, and they then are employed side by side with the women. The situation is similar in the public high schools. Most high school teaching is done, at least in the United States, by women. But some men there must be, if only for the better maintenance of discipline; and indeed the juster opinion is that secondary education would be much improved if the proportion of men were greater. When men and women thus work side by side, doing apparently the same work, they yet receive different wages. The specious cry of "equal pay for equal work" is sometimes raised in such cases; though in fact the work is not

equal, for the men could not be completely replaced by women without loss in efficiency. Where work (that is, efficiency) is in fact equal, the action of competition will in the end make pay equal, — equal at the lower level, if enough capable women can be found, and equal at the higher level if men must still be enlisted. This, we say, will be the outcome in the end. But, as in all such adjustments, there may be a period of transition and experiment, during which the practises of industry have not yet accommodated themselves to the forces of competition; and during such a period the tradition that women's wages are lower than men's doubtless has its effects on relative wages.

The employment of unmarried women is in the main a gain for society and a gain for the women. This is even more true of women from the well-to-do classes than of their poorer sisters. It is better that they should be at work, rather than idling, during the period when they are looking forward to marriage; and what they produce, even though it be not turned out with great efficiency or for wages as high as they would like, adds to the social income as well as their own income. Their being at work is often opposed by the men, and by some well-meaning reformers, on the ground that it takes the bread away from some one else, — a phase of the pervasive fallacious notion that the community is worse off if its labor force is utilized to the utmost.[1] What is true of women awaiting marriage is even more true of women who do not marry at all; their own happiness as well as their usefulness in society is immensely promoted if they have stated work, paid for at its market value.

But women's work, and especially the work of young unmarried women, must be safeguarded in such way as to conserve health and character. There should be stringent regulation as to the permissible age, the hours of work, ventilation and sanitation in workshops. No utilization of productive forces can be more wasteful than that which impairs the moral or bodily soundness of future mothers. The circumstance that

[1] See below, Chapter 51, § 3.

they are usually poor bargainers — partly for the very reason that they are at their tasks temporarily — renders them liable to exploitation, and makes legislative regulation of their labor the more imperative.

The employment of married women or widows, having minor children, is almost always bad. What it adds to social income is much more than offset by the social loss from unkempt homes and from lack of care for the young. It must be regarded, where necessary, as one of the harsh necessities of an individualistic society. Some charitable organizations have adopted the policy of deliberately paying penniless widows, not for work outside the home, but for staying at home and caring properly for their families. It is under consideration in Germany that the great system of workmen's insurance, which now provides for the contingencies of sickness, accident, infirmity, and old age,[1] shall be extended to provide for widowhood also. Through some such measures there may be found a way of mitigating this bitter hardship.

[1] See below, Book VI, Chapter 58.

CHAPTER 48

Wages and Value

§ 1. In the present chapter we return to the theory of value, and its connection with the theory of distribution. So close is that connection that the two subjects might be properly treated as one. It is chiefly for convenience and clearness in exposition that they have been separated in this book.

Let the reader recall the distinction indicated by the phrases "cost of production" and "expenses of production."[1] By expenses of production we mean the outlays that must be made to bring a commodity to market, — what must be paid for wages, materials, and the like. Since the materials themselves are made by labor, and the outlays of capitalists are resolvable into a succession of advances to laborers, expenses of production in the end are simply wages.[2] By cost of production we mean efforts and sacrifices — mainly labor. The distinction between expenses and cost — between wages and labor — is an obvious one and an important one, though unfortunately not indicated by any well-established phraseology. In everyday language people mean by "cost" employer's outlays; and this current usage was accepted in most of what has preceded. In what is to follow, it will be helpful to keep these two notions distinct, and "cost" will be used in the sense of labor or effort.

If competition between laborers were perfectly free, — if there were no non-competing groups, — expenses of production, so far as they consisted of wages, would perfectly measure cost or effort. There could then be no differences of wages, except such as served to equalize the attractiveness of different

[1] See especially Book II, Chapter 12, § 1.

[2] Compare Book I, Chapter 5, § 5; and Book V, Chapter 38, § 3.

employments. Higher wages in any one occupation would then signify that the work in it was harder, more disagreeable, in less esteem; in other words, that it involved greater effort or irksomeness, that is, greater cost.

Under such a supposition, it would be possible to maintain a labor theory of value: that the value of commodities measured or embodied the labor given to producing them. Higher value would be the result of more outlay in wages, and more outlay in wages would mean either more labor or labor of a more irksome kind; that is, higher cost. This conclusion would assume also, to be sure, that competition among capitalists was free, and that all capitalists' outlays in the way of wages were weighted, or added to, in the same proportion, in order to yield a return on these outlays in the form of interest. As this weighing, or addition for interest, would affect all commodities equally, value, being only the expression of a relation, would not be affected by it[1] For the validity of this conclusion, it must further be assumed that temporary fluctuations, or "market values," may be disregarded. With free competition both of labor and of capital, supply would be so adjusted in the long run that no one set of laborers or of capitalists would secure higher rewards than any other set. Supply being so adjusted, value would be regulated fundamentally by quantity of labor, or by cost.

§ 2. In fact, however, as we have seen, the movement of labor is not free. Looking to this circumstance alone, and disregarding for the moment the same possibility as to capital, — that is, assuming capital to compete freely, — let us consider how value would be adjusted. Suppose a non-competing group of workmen which comprises a single trade, say glass blowers: what will determine the value of the commodities made by them?

The answer is simple: marginal utility. That will deter-

[1] The reader conversant with the history of economic theory need not be reminded of the qualification of this proposition which was so much dwelt on by Ricardo and his followers. See Ricardo, *Political Economy*, Chapter I; J. S. Mill, *Political Economy*, Book III, Chapter IV.

mine both the wages of the glass blowers and the selling price of the window glass and other articles made by them. The quantity of such articles put on the market would be limited by the number of workmen in this group. As the capitalists compete among themselves (by supposition), they bid for the services of this particular group of laborers until nothing is left to themselves but ordinary interest. A current high rate of wages for such laborers will establish itself. Every capitalist will regard his outlay for such wages as part of his "cost"; that is, of what we here call the "expenses" of production. The selling price of his wares seems to him to be based on what he has to pay to his workmen. People are constantly saying that they are "compelled" to pay the ruling rate of wages or the ruling price for an article, forgetting that one of the things that establishes the ruling prices or ruling wages is their own willingness to pay rather than go without. It is the bidding of the capitalists for workmen that causes the high rate of wages; but that bidding rests on the high prices which buyers pay for the wares,—that is, on the utility of the wares to them. Not quantity of labor, but utility, then would govern value; not the conditions of supply, but those of demand.

This simple case gives the key to the phenomena of value under the conditions of non-competing groups. But before it can be applied, sundry qualifications and amplifications must be considered.

In the first place, it is rare that the workmen in any single trade are able permanently to shut out competition. The case of glass blowers has been adduced, by way of illustration, because it approaches that possibility. Glass blowing is (or was) one of the few trades which have preserved down to our own time the characteristics of a highly specialized handicraft. In general, workmen are partitioned into groups, not trades. There may, indeed, be temporary variations of wages, and these of a considerable sort, because of sudden changes in the demand for one or another kind of labor. Activity in the iron industry, for example, or in building operations, may cause unusually

high wages for the needed mechanics. Such variations endure longer than economists have been apt to suppose; and the workmen themselves, as well as their employers, often speak and act as if they would last indefinitely. In fact, unusually high wages of this sort attract other workmen from the same group in society, and so set in motion forces that bring them down to the level common for the group. Wages tend to be adjusted roughly to the same level for all the workmen in any one social and economic layer.

The influence of demand or utility in determining the range of wages in any one large group is far from simple. Labor of any kind has a derived utility. The glass blower's labor has a utility derived from that of the glass he makes; that of the ironworker a utility derived from that of the crude or finished iron. But it is an artificial simplification of industry to think of the glassware or iron as if made by the glass workers or iron-workers alone The iron, for example, is made, not by the puddlers or rollers only, but by them in combination with the miners who dug the ore, the railway workers who helped to carry it, the common laborers who are employed in each of the stages, — not to mention the managers, foremen, trained engineers. Only in comparatively rare cases — as with the services of physicians or domestic servants — do the workers supply single-handed the utilities on which their pay rests. Ordinarily, workmen of different kinds and grades combine to make a commodity. All are equally indispensable; utility and marginal utility are attributes of the commodity as such: how say whether the skilled mechanic or the common laborer has greater share in yielding the utility?

The principle of marginal utility is here applicable under the guise of marginal efficiency or marginal indispensability. Consider, for example, the case of common unskilled labor. It is cheap because there is plenty of it. If there were very little of it, it would be in the highest degree indispensable, and would be paid for at a corresponding rate. Being plentiful, it is applied not only to operations that are indispensable, but to

others that are less and less needed, until finally its marginal application is reached at the point where it is least needed. While in some directions it adds enormously to the output, or to the joint efficiency of all the labor with which it is combined, in others it adds less. It is its marginal efficiency that determines the pay which the whole must accept. So it is with skilled labor. In some directions it is in the highest degree important; the loss, were it taken away, would be very great. It is the loss, or diminution in output, which would ensue if the last installment of it were taken away, that determines the remuneration of any one kind of labor.

The principle, it is obvious, is essentially the same as that applied to capital:[1] the contribution or addition which the marginal installment of capital makes to the output determines the return on all capital. Similarly, the marginal contribution from any grade or group of labor determines the remuneration of all within that grade. Both for capital and for groups of laborers this principle works out its results by a slow-moving but persistent and powerful process. The market variations of wages, the struggles and debates of the day, seem to be carried on quite without regard to it. But the "fair" wages to which appeal is constantly made in current contentions are in reality the wages which this slow-moving process tends to bring about.

The ultimate determinant of value, then, where there are non-competing groups, is marginal utility, not cost in the sense of labor or effort. Between the members of any one group, it is true, exchanges are conducted, and remuneration is determined, on the basis of cost. Skilled workmen in buying each others' products, and lawyers and physicians in buying each others' services, exchange in proportion to labor, and earnings within each group are determined in the long run by an equalization of effort. Between groups, however, this is not the case. The range of pay in the "liberal" professions and in the occupations of the well-to-do generally, is high because their members are limited in number compared to the manual laborers,

[1] See Chapter 38, § 4.

and the marginal utility or efficiency of their services, is therefore high. So it is as to mechanics and skilled workmen of al' sorts: their scarcity relatively to the demand for their services, — that is, the marginal utility of their services, — gives them an advantageous position and a comparatively high remuneration. Expenses of production, or outlays paid to secure labor, are thus the results of value rather than the causes of value.

§ 3. Some qualifications to this conclusion must be noted, in another direction. The remuneration of a group must not be so high as to attract laborers from another group. The barriers between groups are not impassable, and with the progress of society they tend to become less and less so. The greater the difference in remuneration, the greater the inducement to get over the barriers, and the more likely a movement of some laborers — the alert and ambitious — into the higher ranks. So far as the obstacles to movement are the result of environment and nurture, the differences between non-competing groups are thus subject to a check. So far as differences in inborn gifts cause them (a doubtful matter, as we have seen), no such check can be in operation.

But even within a group, numbers may increase, through the growth of population. We may conceive that a high rate of pay among, say, skilled laborers would lead to early marriages, more births, and so eventually to an increased supply of such laborers. Conversely, we may conceive that if the rewards in a given group — say in the liberal professions — were low, marriages would be delayed, births diminished, and the supply of such labor lessened. Movements of this sort would depend on the standard of living within the group. A standard of living so tenaciously held as to affect natural increase may be a force in the background, fixing a sort of supply price, and in the end affecting relative wages more fundamentally than marginal efficiency. There is evidence that a force of this sort acts on the numbers of the well-to-do in modern countries, and aids in keeping them in their favored position; and there is evidence, too, that the same force is coming into

operation in the upper tier of manual workmen. But on this topic, and on the mode in which wages are affected by the increase of members and the standard of living, more will be said later.[1]

§ 4. The general principles of value, as they were stated in Book II, are not so profoundly modified, by the theory of non-competing groups, as at first may seem to be the case. It still remains true that varying expenses of production are the causes of most *changes* in value.

When once the broad lines of social classification are established, and the earnings of different groups adjusted to their numbers and their marginal efficiency, relative wages become comparatively stable. As Ricardo said, "the scale, when once formed, is liable to little variation."[2] Changes in demand cause labor to shift from one occupation to another within each grade, but rarely cause a noticeable change in the demand for all the laborers in the grade. Hence variations in expenses of production and variations in cost of production ordinarily run together. The employer is right in thinking that the wages he must pay to the unskilled, to mechanics, to trained engineers, are settled once for all by forces with which he has nothing to do. The forces determining them are so broad and pervasive that his particular demand, though it forms part of the whole demand acting on each group, is lost in the total.

Only long-continued and far-reaching changes in demand affect the relations between non-competing groups; and only then do expenses of production (that is, relative wages) appear as results, not causes, of changes in value. If, for example, the arts of production should be so modified that common labor would need to be applied less and less; if machinery were so perfected that ordinary delving and hewing were done by intricate apparatus made and guided by skilled mechanics, — the relative situation of these two groups would be changed. Unskilled laborers would be less needed, and, if their numbers

[1] Compare Chapters 52 and 53, on Population.
[2] Ricardo's *Works*, p. 15.

were the same, the marginal efficiency of their labor would be less. The converse would happen as to skilled laborers: they would be more in demand, and the marginal utility of their labor would be greater. Possibly some such change is slowly taking place in the countries of advanced civilization. Common labor, it is true, can never be dispensed with; but in many directions the need for it seems to be becoming less.[1] If wages for this group are to rise, it must be chiefly by a decrease of supply rather than by an increase of demand; by that process of escape into other and better-paid groups which is the natural result of universal education and democratic freedom.

To repeat, such shifts in the economic relations of the social groups take place so slowly that they may almost be disregarded. Possibly the time will come when the social stratification of our time will have been obliterated; when all sorts of work will be rewarded in proportion to the sacrifices involved; when all sorts will be in equal esteem; when the common laborer and his children will have the same opportunities for education and advancement as the mechanic and the lawyer. Then expenses of production or relative wages will have very different aspects from what they have now. Though real differences in wages may still persist, because of the inborn differences of men, they can hardly fail to be much less pronounced than they now are. Under existing social conditions, however, such possibilities may be disregarded. Variations in reward are the stable results of the generally constant demand for the different kinds of labor. Changes in value are commonly due to changes in the quantities of the different kinds of labor called for, that is, to changes in cost; though the general scale value is the result of demand and utility, not of quantity of labor.

§ 5. Similar reasoning is applicable also to the theory of

[1] The demand for unskilled labor seems to be great when plant and machinery are being constructed. Once the railways, canals, factories, and so on, are in operation, the demand is more largely for a grade of labor above that level.

international trade. That theory, as it was stated in the preceding Book on international trade, rested mainly on a labor theory of value.[1] It assumed that those things were cheap in a given country, and hence likely to be exported from that country, which were produced with comparatively little labor; while those were dear, and were likely to be imported, which were produced with comparatively much labor. At first sight, it seems that all these conclusions fail if we adopt the principle of non-competing groups and of marginal utility as the ultimate determinants of value. Things are cheap, and likely to be exported, not simply because their cost in labor is low, but because of the complex social conditions that determine within a country relative wages and relative prices. Yet the correction called for in the theory of international trade is, after all, not far-reaching.

The correction would be vital if the phenomena of social stratification were very different in different countries. Then it might happen that one kind of labor — say skilled mechanics' — was cheap in one country and dear in another; whence it would follow that the former country would export the products of such labor. If another kind of labor — say routine factory labor — was cheap in the second country, this country in turn would export the products of that labor. But in fact the phenomena of social stratification are not widely divergent. Non-competing groups on the whole are arranged in the same series of grades in different countries. Such at least is the case as between the civilized countries; they show essentially the same cleavage between the soft-handed and the hard-handed classes, the same steps from skilled mechanic down to common labor. Hence, as between the countries, these great social demarcations are more important within their own borders than in their exchanges with each other. These exchanges still rest in the main on comparative efficiency of labor. It will happen more frequently than the older economists thought that peculiar variations in wages — wages in some

[1] See especially Chapters 34 and 35 of Book IV.

one grade or occupation lower in one country than in another — will explain the exportation of a particular commodity. The so-called parasitic industries of Germany and England supply illustrations. Certain sorts of educated labor, again, are comparatively cheap and plentiful in Germany; such is the situation as to German compositors trained to set up books in the ancient languages, and as to German makers of some musical instruments. But these are not the ruling or typical cases. The main currents of international trade are still determined, as between the civilized countries at least, by the comparative efficiency of labor in producing the imported and exported commodities.

§ 6. The exchanges between different countries are analogous to the exchanges between non-competing groups within a country; and the resemblances illustrate so well the play of the value-determining forces that they deserve some fuller consideration, even though at the expense of prolonging still further the present digression from the subject in hand, — distribution.

As between nations, so between social groups, the range of money incomes is the instrument and the decisive test of gain; and that gain is realized in the purchase of the things or services provided by other groups. An American or Englishman secures the greatest advantages of international trade when he buys tea, coffee, spices, — that is, things made by low-wage labor in tropical countries. Similarly, the lawyer or business man secures his greatest gains from the exchanges between social groups when he buys things made, or services provided, by those who are in the lower groups. His money income goes far in the purchase of the services of domestics, — of choremen and chorewomen, maidservants, grooms, and coachmen. But it is of no special advantage in paying the bills of physicians and dentists: these are in the same group with himself, and their services must be paid for at the higher rate there prevalent. If the labor of physicians and dentists were peculiarly efficient, their services would be cheap, while yet their incomes would be high in accordance with the standards of their social group. Not being effi-

cient in any unusual degree, their services are dear; precisely as, in any country of high money incomes, those domestic commodities are dear in which there is not special efficiency of labor.

The analogy between nations and non-competing groups may be carried further. The rates of exchange in both cases are settled by broad causes, acting slowly and little liable to disturbance except over long periods of time; and hence they are assumed by most persons, and indeed by most economists, as matters of course. That money incomes should be comparatively high in the United States and England and France and Germany, is commonly accepted as part of the order of nature. The fact that the money incomes of physicians and lawyers and the upper tier of business men are comparatively high is accepted in the same unquestioning way, because of the familiarity and the permanence of the differences. In both cases the differences are, none the less, due to causes which are to be found proximately in the conditions of demand between groups and between nations. Lying back of these conditions of demand may perhaps be found deeper causes, — inborn and ineffaceable differences in intelligence and character. We have seen how difficult it is, as between social groups, to decide whether acquired or inborn traits determine the lines of social divisions. So as between nations, it is not easy to say whether the advantages which one country or another may possess are due to unalterable racial qualities, or to the accidents of historical development and acquired skill. Probably the racial causes tell more in settling the differences and the resulting exchanges between a civilized nation and a barbarous or semi-civilized; whereas, between the civilized nations themselves, acquired traits are of more importance. However this may be, the differences exist, and not only exist, but maintain themselves through generations and centuries; as do those between social groups within a country. At any given time, and for considerable periods, they must be accepted as settled facts, and thus as causes, not analyzed as results.

CHAPTER 49

Business Profits

§ 1. We return now to the main course of the argument, resuming the subject of distribution. Business profits present many of the problems presented by differences of wages, and are best regarded as simply a form of wages. Yet they have many peculiarities and call for separate consideration. Various phrases have been used to designate this share in distribution: "wages of management," "net profits," "business earnings," the reward of the "entrepreneur" or "undertaker" or "enterpriser." The term "business profits," as used in everyday speech, comes sufficiently near to designating the sort of income now to be considered, and the term "business man" similarly indicates what kind of person secures it. These terms will be used in the following pages.

The independent conduct of industry is the salient characteristic of the business man's work. He assumes the risks of the outcome of industrial operations; whereas the salaried person or wage earner has a definite amount promised him in advance for settled duties. In this respect, it is immaterial whether the business man conducts operations on a large scale or on a small. The village cobbler and the owner of the large-scale shoe factory, the petty shopkeeper and the great merchant, the peasant proprietor and the estate farmer, alike are business men and earn business profits. The physician or lawyer who is engaged in the independent practise of his profession is, from this point of view, in the same class; for his position evidently differs in a similar way from that of the physician or lawyer who is engaged at a fixed salary. But usually we think in connection with business management chiefly of those

who conduct operations on a considerable scale, who hire others to work for them and under them, who have to make plans of some complexity, whose own work is mainly or exclusively the direction of affairs. We think, too, of the more common industrial operations in trade and manufactures. We shall best approach the special problems of business profit by first considering these familiar and typical cases.

§ 2. The business man stands at the helm of industry and guides its operations. Into his hands first flow the proceeds, and he distributes to others their shares. He pays to the hired workmen their stipulated wages. Similarly, to those who lend him capital, he pays stipulated interest. It is his weighing and guessing of the money-making possibilities of different sites that determines the rent of urban land, and he pays to landowners their rents. After making these various payments, he retains in his own hand what is left. His income may therefore be described as residual.

This position as residual claimant explains one striking characteristic of business profits,—the irregularity of the income. In one year the business man may earn nothing, may even lose. Another year he may gain great sums. The variations from year to year of the same individual's profits arise from the business man's assumption of industrial risks. Though some hazards are so regular, in their occurrence over a large number of cases, that they can be insured against (fire and loss at sea), most must be borne once for all by the individual who first assumes them; as those from fluctuations in demand, inventions and new processes, ups and downs in general prices. The net income of the business man is inevitably fluctuating.

The business man more especially feels first the effects of changes in prices. When prices rise, he gains for a while; when they fall, he loses for a while. This is true of changes in the prices of particular commodities, for the business men who have to deal with those commodities; it is true of changes in general prices, for business men as a class. Hence many people get the impression that buying and selling, and skillful

manipulation of prices, are of the essence of business. It has already been pointed out[1] in what way rising and falling prices affect the relations of business men as employers with the laborers whom they employ. There is a close dependence of business profits on prices, the business man being the buffer for the first effects of all changes in the value of money. But this is often a temporary relation; it affects the fluctuations in his income, but does not determine in the long run its amount or indicate its source.

So great are the risks of business that many people, again, look upon it all as a game of chance. Some win, some lose, — it is but a great lottery. And there are not a few individuals who actually enter on business operations in this spirit, with as little close calculation or careful management as a gambler uses. But it requires no refined observation to show that success is not entirely a matter of luck. True, there are gains in one year, losses in another. Sometimes it even happens that permanent success is won by chance. A turn in the market, a new commodity, a new mine, may yield a fortune, — the business man's goal. One who has thus won a prize may have the good sense to stop, and to withdraw with his winnings from the uncertain arena. But usually he tries again, and still again. Then over a series of years it appears that some individuals show a steady balance of gains, while others in the end lose and disappear from active business. The elements of success are various, — shrewdness in meeting risks as well as skill and ability in organization. But continued success is not due to chance. It is due to the possession by some individuals of qualities not possessed by others.

Again, these qualities are possessed in very varying degree, or at least with very varying results, by different individuals. The great range of this income is even more striking than its irregularity for any one person. Some men seem to have a golden touch. Everything to which they turn their hand yields miraculously. They are the captains of industry, the

[1] See Book III, Chapter 22, § 6.

"big men," admired, feared, and followed by the business community. Others, of slightly lower degree, prosper generously, though not so miraculously,—the select class of "solid business men." Thence by imperceptible gradations there is a descent in the industrial and social hierarchy, until we reach the small tradesman, who is indeed a business man, but whose income is modest and whose position is not very different from that of the mechanic or the clerk.

A wide range in the earnings of individuals doing the same sort of work is a peculiarity of all intellectual occupations. Though some mechanics are more skillful and better paid than others, the differences are not comparable to those between lawyers, physicians, artists, business men. This is due to the fact that the differences between men in intellectual endowments are vastly greater than the differences in manual vigor and aptitude. Though not every man can be made by training and practise a skilled mechanic, very great numbers can be brought to the highest possible pitch of such skill. It may be that many more men could be made by training into serviceable physicians and lawyers and business men than in fact are so made; but the number who can attain the highest possible pitch of skill in these occupations is very small indeed.

§ 3. The differences in the long-run earnings of different business men raise the same questions as were considered with reference to ordinary wages. Are they due to differences in inborn abilities? or are they the results of training and environment? Do the more prosperous business men spring from the general non-competing group of the well-to-do, with all the advantages of that class? or is their success irrespective of their start in life, and due mainly to natural endowment?

Some familiar phenomena point to the explanation on the ground of inborn differences. Poor boys rise to fortune. In the United States the farming class has been a great nursery of fortune builders. On the other hand, the sons of these very captains of industry commonly drop from the posts of leadership. Notwithstanding all the advantages of training, not-

withstanding the inheritance of means and of favoring opportunities, they are apt to resign the active conduct of business to men who again have risen from the ranks. Cases of this sort, to be sure, are not always so significant of the non-inheritance of business ability as they seem to be. The failure of the rich man's sons to emulate his achievements may be due to lack of motive, not lack of capacity. The spur of need and of unsatisfied social ambition is lacking. None the less, there are cases in plenty where those to whom the management of an established business is bequeathed, fail to maintain it even though they try. Again and again old-established firms whose founders have passed away go to pieces under the management of the heirs.

But here, as with other occupations, there is danger in fastening attention on the conspicuous phenomena alone. Captains of industry are doubtless born. So are great poets, musicians, men of science, lawyers. Though there may be occasional suppressed geniuses among the poorer classes, ability of the highest order usually works its way to the fore. Talent and good capacity, on the other hand, are much less rare, and they need to be nurtured. A favorable start may bring success to one man of good ability; its absence may prevent another no less able from rising. Beneath the highest tier of the extraordinarily capable business men, there is a great stratum of prosperous and well-to-do persons, to whom the advantages of capital and connection have been of cardinal importance.

Capital and connection, — these are the two factors which may make a business career, whose absence may mar it. Every business man must have the command of means, his own or borrowed. True, if he has the highest abilities, lack of means will not long embarrass him. His start may be slow, but he will soon have savings of his own, will borrow easily, and before long will find associates who are not only willing but eager to intrust to him all the money he wishes. It is otherwise with the man nearer the average. If parents or friends supply him with the command of capital, he has a great advantage over

the less favored of the same ability. So it is with connection, — not merely acquaintance and relationship, but all the varied influences of environment. He who is born in the well-to-do classes is surrounded from the outset by the business atmosphere. Traditions, advice, opportunities, come to him spontaneously. Whatever abilities he has, find a favoring ground for their development.

Set training doubtless counts for less in the business career than in the other occupations of the well-to-do. There is no education for the business man comparable to that required for the engineer, the physician, the lawyer. Though it is probable that in the future business training will be less haphazard than it has been in the past, and will be in greater degree the object of methodical instruction, set teaching will never play the part which it plays in the professions. The career will be always comparatively easy of access. The obstacles to be surmounted will be chiefly those from lack of means and from all the vague but potent influences of environment.

§ 4. The business man of the first order must have imagination and judgment; he must have courage; and he must have administrative capacity.

Imagination and judgment, — these are needed for the generalship of industry. The successful business man must be able to foresee possibilities, to estimate with sagacity the outcome in the future. Especially is this necessary in new ventures; and it is in new ventures that the qualities of generalship are most called for, and the greatest profits are reaped. Countless schemes for money-making are being constantly urged on the business community, most of them visionary. Among them the captain of industry will pick out those that really have possibilities, will reshape and develop them, and bring them eventually to success. Sometimes he errs; there could be no great successes unless there were occasional failures; but the right sort of man has a handsome balance of profitable ventures. Not infrequently those are supposed to have the requisite judgment who in fact do not possess it. Personality tells, but

may be deceptive, — a vigorous presence, incisive speech, kindling enthusiasm. Time and again an individual with such a personality secures a hold and a following, and is enabled to embark on large ventures. Yet, finally, he comes to grief because in the end he proves not to have the saving quality of judgment.

Courage and some degree of venturesomeness are obviously essential to the successful business man: so much follows from that assumption of risks which is of the essence of his doings. But courage and imagination and personality will not avail in the end unless there be sound judgment.

Executive ability is probably less rare than the combination of judgment with imagination. But it is by no means common. It calls, on the one hand, for intelligence in organization, on the other hand for knowledge of men. The work must be planned, and the right man assigned to each sort of work. The selection of efficient subordinates is of the first importance. A vigorous constitution — vigorous in its capacity to endure prolonged application and severe nervous strain — is almost a *sine qua non,* as it is with the military leader.

A business man almost always has to do with the physics and mechanics of industry. Every director of large enterprises must choose between competing mechanical devices, must watch the course of invention, must be in the fore with improvements. It might be supposed, therefore, that men of mechanical talent would become the leaders in industry. Yet this is by no means the common case. Most frequently the inventors, engineers, and mechanical experts are in the employ of the business man. Occasionally an individual appears who has in high degree both the business qualities and the inventor's qualities. Such were Stephenson the English engineer, and Werner Siemens among Germans; such is Edison among Americans. But the union of two diverse kinds of ability in one person is no more common here than in other walks in life. Usually the sort of judgment, insight, courage, persistence, which are needed for the development and wide use of improvements are not possessed by the

inventor himself. Watt, the inventor of the steam engine (or at least its successful perfector) needed the judgment and resource, as well as the capital, of his business partner, Boulton. Ericsson was an inventive genius of the first order: his screw propeller revolutionized marine transportation, and his *Monitor* influenced to hardly a less degree the development of modern warships. But he pinned his faith also on the caloric ship, regardless of the fact that the required bulk of the machinery was excessive.[1] In selecting among the numberless projects constantly pressed on his attention, the business man exercises one of his most characteristic functions.

Too much stress must not be laid on any enumeration of the business man's qualities. All sorts and conditions of men prove to have the qualities needed for pecuniary success, — the cautious and the daring, the sober and the enthusiastic, the loquacious and the taciturn, those given to detail and those negligent of detail. The different aptitudes appear in every kind of combination. Some heads of large organizations keep every thread in their own hands, and not only plan the large outlines of their ventures, but look to every detail. Others intrust almost all administration to subordinates, and keep themselves free to think, plan, confer. There are those who keep strictly to "their business," — the particular branch of industry in which they have embarked; and again there are those who launch freely into new and varied enterprises. No one key opens the doors to success.

The differences are equally striking as to qualities not directly connected with pecuniary success. Some business men are of intellectual bent, others are dullards in everything but business. Some deal generously with their employees, others constantly scheme to overreach them. Some are high-minded and public-spirited, others mean and selfish. Thirty or fifty years ago, writers on economic and social questions were prone to celebrate the virtues of the class. In recent years, "business"

[1] The ship which he equipped with the caloric engine was propelled perfectly See Church, *Life of Ericsson*, Vol. I, Chapters XI, XII.

has come to be in bad odor; it is associated in many minds with grasping monopoly, manipulation of securities, tyranny over laborers. In truth, the business man at his best is an admirable figure in our modern world, and at his worst is a very ugly one. The variety among the men who prove to have the money-making capacity is a standing cause of wonder.

§ 5. Among all these different sorts of persons, a process very like natural selection is at work. To predict who has in him the qualities for success is much harder than is prediction with regard to most occupations. The aptitudes and abilities which must be possessed by one who would succeed in law, in medicine, in engineering, in teaching, show themselves at a comparatively early age, and a friendly observer can often give good advice as to the choice of these professions. But the qualities that make for success in business management not infrequently develop late, or at least show themselves late and only under actual trial. Surprises are more common in this walk of life than in any other. A constant process of trial is going on. Those who have the requisites for success come to the fore, those who lack in some essential drop to the rear.

The drift of all this is that in the business career, as compared with most others, inborn capacity counts more, training and environment less. Environment and ease of start seem to be of consequence in what we may call the middle range of the occupation, — the businesses of moderate scale, requiring a substantial capital and yielding respectable middle-class income, but calling for no unusual degree of judgment or administrative ability. The growth of large-scale operations in every direction has made businesses of this sort relatively less important and numerous than they were half a century ago. No doubt, they are still numerous and important; and, as to them, there may be something like a caste or non-competing group. They tend to remain in the hands of those who have the advantages of capital and connection. As to them, it may be true that there are plenty of persons in the so-called lower group of society and in the working classes who could take charge equally well. But in

the upper range of the business world, in the large enterprises which dominate more and more the industry of modern times, native ability tells.

Native ability is recruited from all classes. There are conspicuous cases of men rising from the ranks. Yet most of those who come to the fore have probably begun with the associations and environment of property and of business. The commonest case is that of the young man born in the middle class, and imbued with its traditions and ambitions, inheriting vigor and judgment, but not enervated by the inheritance of large means. As has already been remarked, the farming class in the United States, which belongs in its traditions and outlook rather to the possessing than to the nonpossessing class, has been in this country a great nursery of business ability. Possibly there is a fund of such ability hidden and smothered among the hired workingmen. But the ease with which capable men make their way, even from the poorest beginnings, speaks against the supposition. So simple is access to this career, so common is the rise of the capable from the ranks, so constant and searching the process of natural selection in the business world, that we may regard it as probable that all who have marked natural gifts are enabled to exercise them. It is almost certain that such gifts have a preponderant influence in determining business success.

§ 6. The aim of the business man is to "make money," and the chief motive which stirs him to making it is social ambition.

The successful business man is the backbone of the well-to-do and possessing classes of modern society. His ambition is to accumulate, not merely to earn a living. The lawyer, the physician, the teacher, is reasonably content if he succeeds in supporting and rearing a family according to the standards of his class, and in making some moderate provision for the future; though, being in close association with the business set, he may be infected also with the fever of accumulation. But the business man cannot escape that infection. The aim of all in his class is to gain more than enough to support. To get together a competence or a fortune is the one test of "success." He must

be able in his later days to live at leisure on his settled income, or at least transmit to his descendants the opportunity of leisure. We do not commonly think of the money-maker as a person who saves. Not infrequently he is a liberal spender. But he spends less than he makes. His one aim is to make a great deal more than he spends, and to put it by. His accumulations, though they may involve little conscious sacrifice, are none the less real savings, and constitute probably the most important source of the community's supply of capital. Though no statistical or quantitative measurement is feasible, it is probable that the larger portion of the extraordinary growth of capital during the last two centuries has come from the competences and fortunes of the business class.

Every successful business man thus leaves behind him a trail of accretions to the well-to-do classes. His children start with advantages of education, environment, easy command of capital. Their occupations, their ambitions, their standards of living, are on a new plane. If they inherit ability, it finds scope for exercise at once. If they have only moderate capacity, the best is made of this by training. Often the riches which they inherit prove a treacherous gift, preventing the use of good natural powers, and encouraging sloth and dissipation. There was a tradition in older days that new-made wealth did not remain long in the same family. It was said to be but three generations from shirt sleeves to shirt sleeves. No such generalization would be tenable to-day. The machinery for safely investing and keeping accumulated property is highly developed, and is at any one's command. They who once possess can continue to hold, and persons who have been lifted among the soft-handed classes cling to their place with extraordinary tenacity. While there is a continuous movement upward,—not great in volume, but steady and considerable,—there is no appreciable movement downward.

The most powerful spur to the business man's activity, to repeat, is social ambition. The deep-rooted impulse of emulation leads him to try to swing himself into the ranks of his

"betters." The pride of commanding the services of others, the instinctive craving for external marks of distinction and superiority, have been gratified in modern times most commonly and most readily through money-making.

Other motives also have played their part. A true taste for the refinements of an easier and ampler life, an appreciation of what is intrinsically and permanently beautiful, has sometimes been a motive to pecuniary gain; though it is to be suspected that genuine feelings of this sort are less common among the business men themselves than among their descendants, and not too common among the latter. The love of power, which is closely allied to the instinct of emulation, is a strong spur to unceasing accumulation. Mere megalomania sometimes appears among the captains of industry, — a desire to bring larger and larger domains under subjection. With all this goes the impulse to activity. Idleness soon palls.. Many a business man whose wealth far exceeds the ambition of his early days continues none the less to scheme and to work, from lack of anything else to do. He has learned to play the engrossing game of money-making; he can play no other that satisfies him for long; he continues to make money in order to escape being bored.

The desire for wealth which possesses the business class is thus not a simple motive, but one very complex. It is much to be wished that other and nobler motives could be substituted, and that the same courage, judgment, and strenuous work could be brought to bear for rewards of a different sort, and with less unwelcome consequences in the inequalities of worldly possessions. Something of the sort is dreamed of as feasible by those who would completely overturn the régime of private property. Not high money gains, but a ribbon, a laurel wreath, the spur of fame, should suffice to call out the best energies of the industrial leader. What may be these possibilities, we shall have occasion to consider elsewhere.[1] Certain it is that in the past the coarser motives have mainly prevailed. In them and in their power among the mass of mankind is the psychological lever

[1] See Book VII, Chapter 65, § 3.

which explains the great upward economic movement of the last two centuries. It is probable that motives of the same sort will long continue to operate, and will long continue to be indispensable for sustained material progress. The business man as we know him, with his virtues and his faults, his good effects on society and his evil, will long be with us. Business profits will long be a factor of the first importance in the distribution of current earnings and in the shaping of social stratification.

§ 7. By way of bringing into sharper relief some of the conclusions reached in this chapter and those preceding, let us make two extreme suppositions: first, that capable business men of the highest order are very plentiful; second, that stout, able-bodied, unskilled laborers are very scarce. In other words, let us suppose that the conditions of supply for these two sorts of social service are precisely the reverse of what they are at present.

If capable business men were very plentiful, every species of enterprise would be conducted with the utmost judgment, vigor, and intelligence. The smallest retail shop would be managed with the same ability as the largest trading or manufacturing concern. At present, the highest ability is turned to those great enterprises in which it tells most; precisely as central sites in cities are turned to those kinds of business for which their advantages tell most. With an indefinite supply of first-rate business ability, this sort of human power would be directed not only to those channels in which it was most effective, but to others in which it was less effective. The gain, or addition to the output, resulting from its application under the least favorable circumstances, — in other words, from its marginal efficiency, — would determine the remuneration for all persons having such capacity. We may assume, for simplicity's sake, all these to be of equal capacity. In the next chapter, the consequences of differences among them will be considered; for the present argument, it is not material whether we assume complete equality or admit some differences of degree. All those of high efficiency would be immensely more plentiful than men of similar ability

now are, and their gains would be very much less than are now the gains of such men.

The general efficiency of all the labor of society under such conditions would be very much greater than it now is. Every business, from the largest factory to the smallest shop, would be so managed as to secure the utmost return for every scrap of expenditure. All goods and services would be more plentiful. But the share going to business men would be less. If we conceive the process to be carried to its farthest limit, and good business men to be as plentiful as common unskilled laborers now are, their reward would be on very much the same level as that now current for common day wages.

Turn to the other supposition. Suppose the human race vastly deteriorated in its physique; the great majority of men incapable of holding the plow or lifting the pick. Then the few who were still able to perform sustained manual labor would receive high rewards. No kind of labor is so little to be dispensed with. As, in the days of Achilles, the huge warrior was the admired hero, so in a society where common labor was scarce, the much-envied person would be the brawny workman. He would be highly paid, because the marginal utility of his labor would be great; and that which is scarce and is paid for at a high rate commands general esteem. No doubt, the muscular laborer would look down with contempt on the rest of mankind, dependent as they would be on him for the necessaries of existence; precisely as the capitalist business man now regards with contempt the day laborer, dependent on him for the opportunity to make a living. Social stratification would be turned topsy-turvy.

Brains being scarce by nature, such a complete reversal of positions is beyond the range of possibility. But some approach to a position midway between the extremes is not inconceivable. Business ability may become much more common than it is now. In the course of generations, the supplies of the different sorts of productive capacity may be greatly changed; and then the variations in earnings, and the consequent differences in social station, may be correspondingly changed.

CHAPTER 50

BUSINESS PROFITS, *continued*

§ 1. In the preceding chapter the earnings of business men have been treated chiefly in their bearing on the problems which are connected with differences in wages and with the social consequences of such differences. We may proceed now to the relations between profits on the one hand, and rent, wages, and interest on the other; and to various ways of making money that are doubtfully to be classed under the head of business profits.

An analogy between business profits and rent has often been pointed out. High capacity in a business man is like high productiveness in a site. The effectiveness of the labor and capital managed by a capable man is greater than that of labor and capital managed by one less capable; just as labor applied on good soils yields more than labor applied on poor soils. If there were an indefinitely extensible supply of able business men, no one of them could secure high earnings. In the same way, good land could not yield a rent if there were an indefinite supply of it. This mode of treating business profits was developed most systematically and emphatically by Francis A. Walker, and it became a corner stone of his theory of distribution.

The same analogy exists in the differences between the earnings of men of varying gifts in other occupations. The talented surgeon or physician earns more than his colleagues because he is more efficient; and so the lawyer, the engineer, the architect. In any group of men who compete with each other at the same sort of work, the more efficient — that is, the more productive — earn more in proportion to their effi-

ciency. So far as the differences are due to inborn gifts, the results are in the nature of rent.

To this it has been objected, most effectively by Professor Marshall, that allowance should be made for the element of risk, and that, when such allowance is fully made, the analogy to rent is shorn of most of its significance. Though there are successful lawyers, there are also briefless barristers. When there are blanks as well as prizes, it may well happen that the prizes do not suffice to offset the blanks, and then the earnings in the occupation as a whole contain no surplus, and there is no element of rent. This, it is said, is peculiarly the case with business profits. Success in business is highly uncertain. Prediction as to any individual who enters it is extremely difficult, especially in the early stages of a career. It has been supposed that only one tenth of those who try to establish businesses of their own succeed in the end. The estimate is but guess work, and very likely exaggerated. But it points to a fact. In view of the risks and the obvious possibilities of failure, must there not be some prizes to maintain the resort to the occupation? When regard is had to business work as a whole and business profits as a whole, can the high reward of the fortunate few be regarded as a real surplus?

There is weight in the objection; but it is not conclusive. It is true that business ventures are uncertain as to their outcome, not only because it is of their essence to assume risks, but because, for new aspirants, it is peculiarly difficult to say in advance whether they possess the qualities which fit them to meet and overcome the risks. On the other hand, the extent of the risks assumed is easily exaggerated. The very fact that no previous expensive training is required lessens the sacrifices and disappointments of those who try and fail. True, they may lose some of the means which they owned or which have been intrusted to them; and this loss is sometimes large. Usually, however, the first steps in business are on a modest scale, and experiment on a modest scale suffices to test whether there is the requisite capacity. If there is failure, the un-

lucky aspirant falls back into the ranks of the hired class, and becomes a clerk, bookkeeper, superintendent. His earning power is less than he had hoped, but it is not reduced to *nil.*

There may seem to be a difference in this regard between the business calling and the professions that require set training. The expensive and elaborate preparation for a legal career may prove to have been thrown away. The would-be lawyer may not have it in him to attain success in the law. But the risk of this in most professions is not comparable to the risk of failure in active business. Ordinarily, he who has a good training for a profession is reasonably sure of getting a living from its practise. He may not win one of the prizes, but he is likely to secure a modest income, sufficient to make the investment in his education worth while. Such is the situation as to physicians, engineers, architects, teachers. The risks are perhaps greater in the law, as the prizes are also greater. Great pecuniary success in the law depends not only on high intellectual qualities, but on the business qualities also. Some professions there are, again, for which a long and elaborate preparation is required, and in which the outcome is yet highly uncertain. Painting, the composition and performance of music, opera singing, are such. Considerable promise, and the presence of a true vein of talent, may yet not prevent eventual failure in these arts; for only a very high pitch of ability and achievement brings a valued success. Even here, there is usually the humdrum routine of teaching to fall back on, — sadly disappointing to the ambitious artist, but usually sufficing to eke out a living. In any case, the artistic callings are exceptional, resorted to by comparatively few and affected largely by other motives than those ordinarily leading men to their choice of a career. On the whole, in the so-called professions, the risk of failure is not great. Investment in an education usually brings its return.

Thus, for somewhat different reasons, the element of risk does not play so vital a part, either in business or in the pro-

fessions, as to neutralize the significance of individual differences in earnings. In business, the initial stake is not so great; in the professions, the winning of a fair return is not so uncertain. Some men are born more capable than others, and the higher range of their earnings, due to unusual gifts, is analogous to rent. Since inborn differences play a relatively more important part in business profits than in other earnings of the well-to-do, the analogy to rent is closer.

But this sort of reasoning can throw light only on the *differences* of business profits, and especially on that upper range of incomes to which hitherto we have chiefly given attention. In the lower ranges of business earnings as well as of professional earnings, the forces at work are the same as those governing wages in general. Hence the rent theory of profits can throw no light on the fundamental questions. These are inextricably connected with the general problem of wages.

§ 2. The differences in the abilities of business men engaged in the same occupation constitute the main explanation of a phenomenon which has puzzled many observers, — the variations in the expenses of production between competing establishments. In the discussion of value,[1] we considered industries having constant returns and commodities whose value is determined by expenses of production uniform for all competitors. But it has been repeatedly pointed out that in fact no such uniformity exists. In no considerable industry of modern times are competitors on the same plane. Some produce more cheaply than others, having better plants, better organization, command of more efficient or cheaper labor or of cheaper materials, more "strategic" location.

If such differences were permanent and unalterable, they would bring all industries into the class of diminishing returns, and would make the principle of rent applicable universally. But they are not permanent or unalterable, except so far as good sites or cheap raw materials are limited. Most of the circumstances which are commonly referred to as showing

[1] See Book II, Chapter 12.

wherein different enterprises have varying expenses are due at bottom to the personal qualities of their business leaders. If some have better plants or more advantageous locations than others, it is because they have been planned with greater skill and foresight. Especially under those conditions of rapid advance in the arts which characterize modern times, opportunities for improvements in the industrial outfit are first availed of with shrewdness and daring by the captains of industry, and then imitated by others of less though still of notable capacity. When the great mass of those engaged in a given industry succeed in adopting the improvement of the leaders, these leaders devise still further improvements; and the differences in facilities and expenses of production are thus maintained indefinitely.

To fit this situation into our reasoning on values and expenses of production, we may adopt Professor Marshall's notion of the "representative firm," — one not far in the lead, not equipped with the very latest and best plant and machinery, but well equipped, well led, and able to maintain itself permanently with substantial profits. Side by side with such representative firms are the exceptional leaders. Side by side with them are also the weak and the struggling, – some under inept management and doomed to failure, and others under good management but still in the early stages of scant capital and unestablished connection. Prices tend to adjust themselves to the expenses of production at the hands of the representative firm. When conditions are normal and settled in the industry, that firm earns "fair" profits, — such business profits as business men of good ability secure in industry at large. Their superiors earn much more. Their inferiors earn less; perhaps go to the wall, perhaps rise slowly to better fortune.

If now an ill turn is encountered by such an industry, — if demand should suddenly fall off, or heavy taxes should be imposed by the state, — the first effect will be to cause the weak and struggling firms to disappear, the representative firms to lose money or at least fail to make money, the leading firms to

submit to lessened profits. The ultimate effect will be that some of the representative firms will withdraw, some perhaps will fail. Some of the leaders will transfer their energies into other directions. Indeed, a keen eye for the prospects of an industry, a shrewd selection of those industries about to enter a period of prosperity and a quick abandonment of those threatened with reverses, are among the qualifications of the money-maker. The converse takes place if an industry has a good turn, through an unexpected increase of demand, or a sustained cheapening of its raw materials. Then every one engaged in it makes money, even the ill-equipped. The able and well-equipped, who happen to be in the best condition for taking advantage of the favorable conditions, may roll up fortunes in short order. How soon and how easily the readjustment to normal conditions will take place depends on the extent of the irrevocably invested plant, on the predictability of demand, and in some degree on the personal characteristics of the active leaders in the industry. As in all matters that depend on human impulses and human calculations, no mechanical regularity in the phenomena is to be expected. It is only in the long run that able business men secure incomes in accord with their ability; it is only in the long run that they and their imitators transfer their energies from unprosperous to prosperous industries; it is only in the long run that the representative firm and its expenses of production prove to have a dominating effect on the range of prices.

§ 3. The differences between individual producers have not only an analogy to rent, but have their effects on rent and on distribution. A capable business man who happens to own an advantageous site may be said to get two sorts of rent, — that from the exceptional site and that from his exceptional ability.

We might expect these two sorts of gain to be quite disconnected. The able man, it would seem, can apply his ability at the margin as well as above the margin. In fact, he usually applies it above the margin. One of the manifestations of

ability is the prompt and full perception of the possibilities of the good sites. They usually get under the control, by purchase or by lease, of the capable managers, and are exploited to better advantage by these than they would be by the less capable. In agriculture, the better farmers buy or rent the better lands, and secure a combined rent of ability and of fertility (or situation) greater than could be secured by ability alone or by fertility alone. This is strikingly the case as to urban rent. The expensive business sites are almost invariably utilized by the upper tier of business men, — the captains of industry and the solid merchants of the great cities. The more expensive the site, the more likely is it to be in the hands of a man of exceptional gifts. There is a sort of pitting against each other of two kinds of rarities, — the sites, and the men. If business men of marked ability are very numerous, they bid against each other for the central sites and urban rent rises to a level by so much higher. If there are fewer of them, they are able in greater degree to retain in their own hands the gains which can be reaped on those sites.

One word more as to the resemblance between business profits and rent. All differences in wages which result from the existence of non-competing groups and which thus are not of the equalizing sort, may be said to be analogous to rent. The carpenter earns more than the day laborer because the supply of his services is limited, and because the utility of his services is greater. There is thus in all real differences of wages an element similar to rent. But there is an important distinction between these cases and the rent of natural agents. In the one, human action and human motive are alone in operation; in the other, nature's limitations are the essential factor. The carpenter and the business man put forth their powers because of a reward, and are stimulated to put them forth the more as reward becomes higher. The differences between good sites and bad sites are irrespective of such motives. And in its social aspects this distinction is all-important. It is not impracticable for society to appropriate in some way

economic rent and monopoly gains. But the appropriation of the extra gains which human beings secure because of their possession of unusual faculties would check the exercise of those faculties. It would, perhaps, be going too far to say that it would quite prevent their exercise. Other motives than those of pecuniary gain may conceivably be made more effective than now. But as men are, and as private property and competition influence them, nearly all need the spur of material reward to bring into full exercise their abilities. The extra gain is a price which society must pay in order to secure the extra service.

§ 4. If business profits are in some respects analogous to rent, they are in other respects closely related to interest.

We have tacitly assumed that so much only of a business man's income is to be regarded as profits as is in excess of interest on the capital which he manages. If he happens to borrow his capital, this is clearly true. He then pays interest to another, and only his net earnings over and above interest go to him as business profits. Usually his capital is partly borrowed and partly his own (or that of relatives or friends, put at his disposal from other than cold-blooded pecuniary motives). On that part which is his own, he must indeed remember that interest could be got at current rates without the risk and labor of actual management; and therefore he must reasonably reckon only the excess over such interest as his earnings of management or business profits. This way of regarding the situation is followed in an arrangement found in many firms which have silent or inactive partners. Out of the net earnings of a given period, say a year, interest is first allowed on the capital put in, whether by the active partners or by the others. The excess, after paying all interest, then constitutes the business profits proper. Out of this, there is first allotted a fixed payment in the nature of salary to the active partners. The remainder is divided between active and inactive partners in proportion to capital provided by them, and constitutes a return for risk, general oversight, and judgment.

Such a sharp distinction between the constituent parts of gross

profits is of course more likely to be made where there is a corresponding division of functions, — where some provide the capital, others do the active work of management; where some share the risks, others do not. In the eighteenth century the common form of business organization, the private firm or partnership, was not such as to suggest the distinction. Then the investor, the person looking to a return in the way of interest only, had little to do with business; his investments were in land or in public funds. The business man borrowed occasionally from banks or professional money lenders, but had no permanent associates divorced from the management. Hence the economists of those days regarded business profits as one homogeneous return secured by merchants and capitalist employers. Among the British economists, this mode of treatment continues nearly to our own day. Adam Smith regarded gross profits as the return both to capital and to the managers of capital. He remarked that double interest was regarded as a fair, moderate, reasonable profit. High profits and high interest went together; and he adduced the historical fluctuations in interest as indicative of the fluctuations in profits.

In modern times the growth of corporations has brought about a vast participation by investors in business enterprises, a division of function between business men and investors, and hence greater attention to the really different nature of their doings and earnings. Many corporations borrow on long time in the form of bonds, whose holders are supposed to be free from risks and to receive pure interest, while yet they are permanently associated with the enterprise. The holders of stock are something more than investors pure and simple. They are, in a way, silent partners; they exercise judgment and assume risk. The actual work of management is in the hands of salaried managers, who in addition may or may not be stockholders.

This relation between the different persons concerned appears most clearly in the early stages of enterprises, especially of large-scale enterprises. The investor who is looking for a return in

the way of interest pure and simple, does not take shares in new undertakings; he buys "solid" bonds. Those who "go in" for new ventures are largely the experienced business men and the clientèle which such business men gather about them. They "go in" largely on their judgment of men. If John Smith, whom they believe in, fathers a scheme, they often take shares without very deliberate consideration of the prospects. They expect to secure more than interest on what they invest; otherwise they would not assume the risks. As time goes on, if the venture has proved successful, and dividends at a good rate have been secured for a considerable period, they sell out to investors at a premium. If the enterprise is then a thoroughly settled one, these investors may take virtually no risks, and their return does not exceed bare interest; though some degree of risk, even if slight, is not to be avoided in holdings of stock. The active business man or venturesome investor who has thus sold out at a profit then turns to still other new enterprises, and may repeat the process indefinitely. His returns are to be considered as, in the long run, mainly business profits, while those of the investor, whether bondholder or owner of "gilt-edged" stocks, are mainly interest, with some admixture of capitalized rent and monopoly gains.

§ 5. For short periods, even for periods of considerable length, business profits and interest are often closely connected. Large command of capital commonly brings to an individual enterprise not only returns in the way of interest proportionate to the amount of capital, but a better chance for large profits. For capital in general, the same circumstances that lead to high returns for the business man lead to high returns for the investor also.

For an individual, the larger or smaller capital which is at his command, and the consequent larger or smaller scale of operations, have an important, apparently a dominating, influence on his net earnings. Those who produce or sell smaller quantities get the same prices as those producing or selling greater quantities. The expenses per unit of the large-scale producer or mer-

chant are usually less than those of his smaller rival. It seems to follow that, merely because he has more capital, his gains are larger. If the management of a great business called for no more ability than that of a small one, and if the command of abundant capital came solely by inheritance or favor, the consequence would certainly follow. But in the long run the connection between extent of capital and volume of profits proves to be by no means automatic. Large-scale operations require more executive capacity, more insight and judgment, more courage, than small. Command of capital comes in the end, not by accident, but according to ability. At the start, and in ordinary times, it is as easy, or at least seems as easy, to manage a large business as a small one. Hence the importance of capital and connection in the earlier stages of every business man's career. Hence, too, the more enduring influence of capital and connection in those businesses which never reach a very considerable scale, or never get beyond the simplest conditions of management. But with almost all enterprises, as time goes on, conditions change, new methods or new processes are devised by the keen-minded and venturesome, and adaptation to new competition must take place. Then, only the able and enterprising continue to control large enterprises and large capital. The less capable fail to make the profits they expect. If, as not infrequently happens, they persist in trying to manage what overtops their capacity, bankruptcy ensues and their all is swept away.

The adjustment of the scale of operations and of consequent profits to individual capacity is much affected by custom, established reputation, and good will. A firm which has been built up by an able founder runs on for a long time of its own momentum. This is particularly true of trading, both retail and wholesale, where connection and reputation count much in holding customers. It is often true of manufacturing, where trademarks may play an important part. It is most of all true of banking, where reputation and good will are of the essence of profitable operation. Hence those who succeed to well-estab-

lished enterprises can continue to reap large gains even though they have no marked ability. But the dominant influence of inborn gifts shows itself in time. Old firms decay, unless regenerated by fresh blood. New firms rise, and a different generation of business men comes into control. Among these may be the capable sons of capable fathers, inheriting ability as well as capital and connection. But most of the new men are not the descendants of the old. They rise by force of character from small beginnings. Into their hands comes the control of large capital and the grasp of large business profits.

§ 6. The same close connection over limited periods, and the same divergence over longer periods, appear in the relations between interest as a whole and business profits as a whole. The factor that proximately determines interest is the amount which business men can afford to pay and which competition compels them to pay. The process by which the return to capital is settled works out its results through its influence on business profits. The advances to laborers are made by the active capitalists, — the business men, — and the ensuing increase in the output comes first into their hands; for they act as intermediaries between the hired workmen and the investors. When gross profits (in Adam Smith's sense of the term) are high, they are able and willing to pay higher interest or higher wages, or both; and conversely they are able to pay less when gross profits are low. Improvements in the arts which increase the marginal productivity of capital tend in the first instance to raise both business profits and interest.

As time goes on, however, the parallel movement is likely to be modified. The mode in which the gain shall be divided between the two depends on the conditions of supply for business capacity and for investors' savings. If savings, and so the command of capital, are abundantly put at the business man's disposal, a larger share goes to his profits. If, on the other hand, a great number of capable business aspirants bid for the savings, a larger share goes to interest. If both capital and business power are in plentiful supply, wages tend to rise; the incomes of the

possessing classes as a whole tend to become less, and the inequalities of wealth are by so much mitigated.

In modern times it is probable that business profits have succeeded in retaining a comparatively large share of the gains from the great advances in the arts. Savings and capital have responded very rapidly and amply to the increased possibilities for investment. The rate of interest has remained, over long periods, fairly stable, notwithstanding the enormous advances in accumulation and in the utilization of capital since the Industrial Revolution set in. All the civilized countries have gone through great bursts of advance, during which the productiveness of labor has been rapidly increased and the opportunities have been favorable for large gross profits and high interest. Such was the experience of England during the first three quarters of the nineteenth century; of Germany during the last quarter of that century; of the United States during almost the whole of her history. Though interest has gone up in all these countries during the accentuated periods of these movements, it has fallen again with each slackening. But business profits have been, for those possessing the qualities of leadership, large throughout, often portentously large.

§ 7. Some different views of business profits — views which bring into deserved prominence certain peculiarities — may now be considered. They distinguish business profits sharply from wages. In them, what a business man gets is regarded as a composite income, even after cutting out such share as should properly be regarded as either interest or rent. Part of what he gets is thought to be simply wages; but part is neither wages, nor interest, nor rent; it is different from any of these; and this peculiar element is alone regarded as "profits."

One form of this mode of dealing with the subject connects itself with what has just been said of the consequences of changes in the arts. Business profits are treated as accruing solely from such changes. If changes in the arts were to cease, if competition were to work out its results perfectly, if prices were to conform closely to expenses of production, the managers of industry

would receive nothing but wages, — wages determined in the same fashion as other payments for labor. But in a dynamic state — a state of unstable equilibrium, of transition, of advance — there is opportunity for business men to secure something more. By taking the lead in utilizing inventions or improving organization they make extra gains, which last so long as they succeed in holding the lead. Business profits, so considered, are ever vanishing, ever reappearing. They are the stimulus to improvement and the reward for improvement, tending to cease when once the improvement is fully applied.

Whether the term "business profits" should be thus limited is primarily a question of phraseology. The emphasis which this view puts on the relation between improvements and the business man's gains is just. The large and conspicuous gains are in fact associated almost invariably with advances in the arts, with boldness and sagacity in exploiting new enterprises and new methods. None the less, this mode of sharply separating business profits from wages seems artificial. Even the routine conduct of established industries calls for judgment and administrative capacity, and so for the exercise of the same faculties that are more conspicuously and more profitably exercised under conditions of rapid progress. To separate even roughly the earnings of a successful business man into two parts — one wages, the other "profits" in the sense of gains from progress — would seem to be quite impracticable. Looking over the whole varied range of earnings among those engaged in the business career, it is simplest to regard them all as returns for labor, — returns marked by many peculiarities, among which the most striking are the risks and uncertainties, the wide range, the high gains from able pioneering.

§ 8. Another view, in some respects similar, separates business profits from wages, by considering as wages that amount which the individual would have been paid if hired by some one else. An independent business man's actual earnings are [illegible] that sum; the excess is business profits. Here [illegible] on the element of risk. Profits differ from

wages in that they are the result of the assumption of risk and the reward for that assumption.

The question here again is one largely of phraseology; but underlying it is the substantial question whether a satisfactory line of demarcation can be drawn, and "wages," in this sense, really distinguished from "profits." Salaried posts of management have a very wide range,—foremen, superintendents, general managers, presidents. A process of transfer is constantly taking place between the salaried ranks and the independent business managers. Both are affected by causes of the same sort. A capable man will make large gross profits for himself, or will be paid a good salary if others hire him. It may even happen that he will really earn more, if hired by others; he may have executive ability, yet lack sagacity and judgment.

The growth of large-scale operations and of corporations has brought increasing employment of salaried men in posts of leadership, and also an adjustment of their pay to the qualities required for leadership. The desirability of stimulating salaried officials to the best exercise of their powers has led to all sorts of devices. On the continent of Europe, and especially in Germany, *tantièmes* are common, that is, a share in the profits, additional to a set salary. In England and in the United States, it is common to pay the managing head of a great corporation a very large salary once for all, with the tacit understanding that he must make the profits large enough to justify the salary. If he would keep his place, he must make money for his employers. This is especially the case in the United States, where larger salaries are paid than in other countries, more power and more responsibility are placed in the hands of managers and presidents, and more is expected from them in the way of "results." T
heads of great American e
a year, even more,—thou
for mere nepotism, in the
from salaried persons the

their own immediate interest would bring out. There is always the possibility of the independent exercise of such ability, and the employing corporations must bid rewards on the same scale as those which it would so yield.

This sort of *de facto* profit-sharing explains why, even under corporate organization, private industry is usually more efficient, or at least has greater probabilities of progress, than public industry. It has been maintained by eminent economists that when once the conduct of affairs is in the hands of great corporations, the essential advantage of private industry is lost; for such corporations, like government, must intrust the actual management to salaried officials, hence lose the spur of the owner's direct interest and oversight. But governments cannot deal with officials with the freedom of private corporations. They cannot pay salaries so high or so elastic; sundry political forces make it impracticable. Though there is a glitter of fame from public employment which may enlist capable men, even with a moderate salary, the same keen exercise of the business faculties has rarely been stimulated. For the most effective organization of the forces of production, private ownership and management, even with salaried managers, has unquestionable advantages.

§ 9. The tenor of the preceding discussion has been to justify business profits, as due in the main to efficiency and ability. The community on the whole gets an equivalent for the business man's earnings; indeed, must allow some such earnings, in order to secure the useful services rendered. But it is often maintained that such justifiable earnings form only a part of business incomes, and that the total incomes much exceed the range of worth-while returns. The contention has truth; there are illegitimate as well as legitimate business profits. To put it in other words, a good deal of "business" is unproductive: it serves not to add to the well-being of the community, but to get something away from other people. [illegible] Gambling speculation, such as that of the "bucket shop," is clearly unproductive. Cor-

rupt contracts with government officials, such as can be sublet by the corruptor to another who actually does the work contracted for, are in the same class. The deliberate manufacture and dishonest puffing of a noxious, or even harmless, "patent medicine" is to be similarly regarded.

Commonly, however, useful and harmful activity, legitimate and illegitimate profits, go together. Take such a case as a subsidy obtained by corruption and not needed to promote the industry in question. The business man's labor in securing the subsidy serves to rob the public; but his labor in guiding the industry may be effectively directed and in its results serviceable. A consistent free trader would say that labor given to manipulating tariff legislation in favor of protected industries was the reverse of productive; but the persons in charge of the industries may manage them well. An employer may take advantage of the helplessness of women and children, of the ignorance and bargaining weakness of unorganized workmen of any sort, and may secure their labor at less than "fair" rates;[1] at the same time he may organize that labor with high efficiency.

There are numberless ways in which the predatory exercise of business power is mingled with activity that is useful. Such are fraud and adulteration in the making of goods; vociferous tooting of an article no better or worse than its rivals, but foisted on a gullible public at a high price by mendacious advertising; cheating of laborers, through "company stores" or in the letting of company tenements, through fines nominally for poor work (weavers), through overcharges (on miners) for materials and supplies. One of the most conspicuous and far-reaching forms of predatory business work is in the abuse of positions of trust by directors and managers, often closely associated with stock exchange [illegible] may violate fiduci[illegible] on the stock excha[illegible] American indu[illegible]

[1] Compare [illegible] VI, Chapters 55 [illegible]

our great fortunes are due in no small degree to this tainted sort of business activity. The proximate aim of the business man is to make money. All is fish that comes into his net. Unless restrained by the law, or public opinion, or moral scruples, he will turn to anything that promises a handsome surplus over expenses.

The restriction of business profits within "legitimate" bounds depends on two things: on the one hand, full and free competition; on the other hand, the maintenance of competition on a high plane.

First, freedom of competition. Monopoly profits are not "illegitimate" in the sense in which are those which result from sharp practise and cheating; but they are "illegitimate" in being greater than necessary to induce the exercise of the full productive faculties. Setting aside such cases as patents and copyrights, they mean that the public pays more than there is any need of paying. Shrewd understanding of the possibilities of monopoly, skillful management of monopoly industries, have been great sources of business men's incomes and fortunes; and this without violation of law or of the proprieties of business life. The regulation of monopoly industries is among the most urgent of social problems, and essential for keeping business profits within the limits of the reasonable or legitimate.

The maintenance of a high plane of competition depends partly on law, partly on public opinion and the pervading moral spirit. The aim of the law is, or should be, to make men's relations with each other such as to promote the general good and to inhibit predatory doings. This is the basis of the main provisions of the law of private property, — protection to property holders, punishment for physical violence and robbery, [redacted] and prevention of fraud. As industrial [redacted], and as men's consciousness of common [redacted], the legal relations are modified. Slavery, [redacted] of the established order of things not only in ancient times, but till nearly our own day, is now forbidden in

all countries that pretend to be civilized. The same is the case with serfdom. Competition and bargaining between men, and the exercise of force, are not allowed to proceed on this basis or to this extreme. Characteristic of our own day is the regulation of the terms of dealings between employer and employed, — laws for regulating the mode of paying wages, the hours of labor, minimum wages, as well as those regulating truck shops and the like possible sources of profit felt to be illegitimate. Pure food laws belong in the same class. So is the improvement of legislation regarding stock companies, the definition and enforcement of the liabilities of directors and managers, the prevention of swindling in promoting and floating corporations. The aim throughout is to compel all persons, and especially the leaders and managers of industry, to conduct their operations under such uniform conditions as will direct their energies to productive and serviceable emulation only.

Public opinion is also an important factor, both in leading to legislation and in adding to the effect of legislation. The more the anti-social effects of predatory activity are recognized and frowned upon, the more will business energy turn to ways of true service. Opinion among business men themselves, and in the whole social stratum in which they live, has been too much dominated by mere money-making, — the worship of the millionaire. The more these classes are permeated by intelligent insight as to what business men really do, and high standards as to what they should do, the better will be the working of the system of private property under the business man's guidance. Widespread teaching of economics, such as is carried on at present in our American universities and colleges and schools, ought to contribute much to this end.

At the best, however, there will always be a residuum of dubious business profits. So long as there is freedom of investment and of contract, there will be foolish investors, hapless speculators, short-sighted bargainers. Shrewd and strong persons will take advantage of the ignorant and weak. There will always be operations as to which it is difficult to draw the

line between fraud and sharp bargaining. There will always be men to whom moral scruples mean little. Some things of this sort are the inevitable concomitants of the régime of private property, which even at its best c[illegible]tified only by a balance of good over bad.

CHAPTER 51

General Wages

§ 1. Wages are so immensely varied that it may seem idle to aim at any generalizations regarding them. They range from the earnings of the highly paid business manager or professional man to those of the mechanic and common laborer. Not less varied are the methods by which those earnings are got. The simplest method, and that which we most commonly associate with the term "wages," is the payment of stipulated amounts by an employer. The earnings of the independent worker — whether he be business man, lawyer, farmer, craftsman — are almost always more irregular, and almost always include some elements (in the way of interest or rent) which are not return for labor. Still different is the position of the metayer tenant and of the fisherman working for a share in the catch.

It will be best to concentrate attention on the simplest case, — that of hired laborers, paid once for all by the day or by the piece. This mode of remuneration brings up the "wages question" in the narrower sense. It is the mode of remuneration becoming more and more common with the spread of large-scale production. It raises the fundamental questions as to the causes determining the general range of wages.

§ 2. First, some erroneous notions may be disposed of. One of these is that lavish expenditure creates a demand for labor, and is good for laborers. On this ground luxury and extravagance of all sorts have been commended, expressly or by implication. The fallacy which underlies it has often been pointed out. That which is saved is spent quite as much as that which is not saved. Most people think only of the first step in the

process of saving and investment, — as if it were merely a matter of putting money by, and leaving it in a bank or other safe place. The money which is put by is turned over to some one else, usually to a person engaged in operations of production. It is simply spent in a different way. It leads equally to the employment of labor, and is equally the means by which the employers and workmen get command of the things they wish to buy. The difference between expenditure on luxuries and investment is simply a difference in the direction in which labor shall be employed.

That difference in direction, of course, may have permanent consequences. It may mean that some sorts of labor are more in demand, others are less in demand. If we imagine that the laborers hired in constructing mansions or pleasure yachts, or in prodigal entertainment, are in one non-competing group, and that those hired in building factories or railways are in another, a change in the direction of demand may permanently influence relative wages. But such a permanent change is very improbable. Temporary changes in wages, on the other hand, caused by shifts in the demand for labor engaged in various directions, are not only possible, but are among the most common of economic phenomena. These shifts are quite as likely to be from one sort of immediate expenditure to another sort — from bicycles to automobiles — as from expenditure to saving and investment. They do not influence for better or worse the total demand for labor.

Looking not to the immediate effects, but to the eventual results, of investment as compared with "expenditure," we may agree with the older economists who maintained that saving was advantageous to the laborers. Investment usually leads to the increase and improvement in the apparatus of production, — the tools, machinery, factories, materials. The eventual result is the production of more consumable commodities than would otherwise be procured. Were tools not successful in bringing about this result, they would not prove profitable and would not be made. The consumable commodities presumably

are, in greater or less part, such as the laborers themselves buy; and by their greater abundance and cheapness the laborers gain. On this ground it may be said that investment as compared with immediate expenditure is better for the laborers as a whole. In the first stages they are neither injured nor benefited; in the end they are likely to be benefited.

§ 3. Still another notion, cropping out continually in all sorts of forms, is that it is advantageous that employment be created or maintained for laborers. A great fire, or a great war, is sometimes thought a godsend to the workingman. A heavy snowstorm is welcomed because it brings employment. And, conversely, improvements and labor-saving machinery are thought to diminish employment; do they not dispense with the services of so many workmen? Laborers themselves are almost invariably desirous of "making work." They believe that a more difficult way of doing a thing, one that calls for more labor, is better for those who have to sell the labor. Few persons maintain views of this sort deliberately and steadily; yet there are few who do not sometimes fall into ways of speech that imply them.

It is obvious that mankind cannot be made better off by causing work to be less productive, or by requiring additional labor for accomplishing the same thing. If there were constant snowstorms and a need of giving unremitting labor to snow-shoveling, so much less labor could be given to operations bringing not negative but positive results. The labor which is given to replacing wealth destroyed by fire or war might have been given to the creation of so much new wealth. The abundance of consumable commodities, on which all material prosperity is bottomed, evidently depends on getting as much done as possible with as little labor as possible. How then can people talk so persistently about the advantages of creating employment?

The explanation is to be found partly in the consequences of the division of labor, bringing as it does a difference between the causes acting on general prosperity and those acting

on particular groups; partly in the necessitous position of most hired laborers.

Where there is no division of labor and no exchange, this notion can never arise. No farmer working for himself will think for a moment that it is for his advantage to choose that way of doing a thing which involves most labor. He will welcome every labor-saving appliance. But when there is division of labor and exchange, every individual's earnings depend not only on the quantity of things which his labor produces, but on the terms of sale for those things. It may be to his individual advantage, and still more often may seem to his advantage, to produce less and sell for more; even though it be obvious that if all men did this, all would be worse off. And similarly it may be to his advantage that his labor should be more in demand, even though the cause be something that lessens the total gain of society. A great hailstorm with many broken windows means a demand for glaziers. If this sort of destruction went on all the time, the number of glaziers in the community would accommodate itself to the situation. More persons would do this sort of work, and less persons would be available for doing other things. Only if the glaziers formed a non-competing group or labor monopoly, would they benefit in the long run. But for a time those glaziers who happen to be on hand, and ready to do this particular sort of work, gain by an increase of demand for their services. Most men see only immediate effects, and draw general conclusions from temporary phenomena. They suppose, or talk as if they supposed, that what is good for a limited number of workmen for a short time is good for all workmen for an indefinite time.

Most important of all, however, in explaining the common attitude of workmen is their position as hired laborers. For them it is of first importance that they be employed. Where permanence of employment is assured, they are rarely opposed to labor-saving appliances. But when they are engaged on a given job, and will no longer be wanted when that job is done, they wish that it shall continue. No doubt, in the interest of

general efficiency in production, it is desirable that this job shall be disposed of as quickly as possible, and that their labor shall then be turned to something else. But where that something else is not immediately in sight, it is natural that they should wish the existing employment to hold out as long as possible. It is the difficulty of transition to another employment that explains the desire to make work, or to keep work going. It is that same difficulty of transition that goes far toward explaining the disadvantages of the workman in bargaining with his employer, and constitutes one of the main justifications of labor unions.[1]

The situation is essentially the same where the workmen of a given trade are confronted with some improvement that causes labor to be more productive. For them, it may mean less employment and the necessity of either accepting less wages or moving to some other occupation. The inventions of the linotype and the typesetting machine greatly increased the output of labor in printing. They diminished also — for a while at least — the demand for compositors. Some of the older members of the trade who could neither work the new machines nor turn to anything else found themselves in a sad position.

It happened in the printing trade, and indeed has often happened in other cases, that the total number of men employed in it, and so the demand for labor in its former employment, did not become less at all, or less only for a very short time. The cheapening of a commodity may mean an increase in demand such that the total sum spent on it may be as great as before, even greater than before. With lower prices for books and newspapers, it is entirely possible that many more will be bought, and more persons, not less, employed in printing them. It has been maintained that such is the common effect of inventions and labor-saving appliances. But this is quite too optimistic a view. The outcome evidently depends on the elasticity of demand for the particular commodity. Only when,

[1] See below, Book VI, Chapter 55, on Trade Unions.

with a lowering of price, demand extends rapidly, is it likely that there will be no displacement of labor.

§ 4. Very different in character from the confused and fallacious notions just discussed is the view, held by many able economists of our day, that the fundamental determinant of wages is the *specific* product of labor. As between labor and capital, each is supposed to contribute a share of its own to the output. There is a specific product ascribable to capital, and a specific product ascribable to labor. Each tends, under competitive conditions, to get as reward what it adds to the product. It is a natural corollary that such distribution of rewards is in accord with justice; though this follows only if it be granted — by no means a matter of course — that distribution in proportion to efficiency is always just.[1]

To enter on a detailed discussion of the reasoning which has been applied to this mode of treating wages would pass the bounds of the present book. The main ground on which it is open to question has already been indicated.[2] It assumes a separate productivity of capital as well as of labor. But capital is itself made by labor; it represents a stage in the applications of labor. If one person makes a tool, and another uses the tool, the two combine in making the consumable thing. Through this time-using and elaborate process more consumable things are likely to be made than would be made in a simpler process; and this increase in the output goes far to explain why there is a return (interest) to the owners of tools. But to explain how a return to the owners arises is not the same thing as to demarcate a separate product. There is no separate product of the tool on the one hand, or of the labor using the tool on the other. There is a joint product of all the labor applied, — earlier labor as well as later labor. We may disengage the causes determining why and how the laborers who use and make the tools get wages, from the causes determining why and how the owner of the tools gets interest;

[1] See what is said under the head of Socialism, Book VII, Chapter 64, § 3.
[2] In Chapter 38, § 3.

but we can disengage no concretely separable product of labor and capital. It is on this ground, here stated as concisely as may be, that I would turn to some other mode of analyzing the causes which underlie the general rate of return to labor.

§ 5. The simplest and clearest mode of stating the theory of general wages is, in my judgment, to say that wages are determined by the discounted marginal product of labor. Let attention be given to the two elements in this somewhat cumbrous formula: "margin" and "discount."

What is meant by *marginal* product will be obvious enough. It appears most clearly as to agricultural produce and with regard to the theory of rent as applied to such produce. Wages and interest are determined at the margin of cultivation. Any excess secured on land better than the marginal land goes to the landowner, and does not affect the returns of other persons. The same principle is applicable to monopoly gains, and to all differential gains. The laborer who deals with the owner of good land, or with a monopolist, must accept what can be paid him by the marginal landowner or the competitive producer. Any extra or differential returns go to the fortunate owners of those instruments which have been sheltered by nature or by social institutions from unfettered competition.

Discount implies an advance. Let it be recalled that production takes time; that the materials and machinery needed in the time-using process are made by laborers. Wealth is unequally distributed, and the immense majority of the laborers have not the wherewithal to support themselves during the prolonged period. Their remuneration is advanced to them out of a surplus possessed by some one else. The operations of capitalists consist in a succession of advances to the laborers.[1] The capitalist class secures its gains through the process of handing over to the laborers less than the laborers eventually produce. The product of labor is discounted by the capitalist employers.

This view may be stated, in more technical terms, by saying

[1] Compare Book I, Chapter 5, § 5; Book V, Chapter 38, § 3.

that labor is a "future" good, in the same sense in which a machine or a store of material is a future good. It is a means by which "present" goods (consumable commodities, or, more strictly, satisfactions) are eventually got. The essence of the explanation of interest is that present goods are preferred to future goods; that present means, or sources of satisfaction in hand, will not be exchanged at par for sources of satisfaction that are to accrue in the future.[1] The same proposition is put in still different terms by saying that "saving" or "postponement" or "waiting" ordinarily involves a sacrifice, and will not be incurred unless there is a reward. The theory of wages is thus strictly consistent with the theory of interest.

In this process of discounting, the whole series of productive operations must be regarded. The "practical" man will readily accede to the notion of a discount, as regards the particular segment of industry with which he is familiar. It will be obvious to him that the laborer cannot be paid as much as the product will sell for; otherwise nothing will be left for the employer and capital-owner. But the advances to laborers are needed for a much longer period than that which must elapse until a salable product is turned out. The salable product is likely to be itself some sort of "capital good"; it represents only one stage in the series of advances. The person selling machines or materials rediscounts, so to speak; the capitalist-employer who buys them recoups the original employer, and then, in the course of the next stage of production, adds further advances of his own to other laborers. Not through one stage only,—not merely in the payment of wages by the individual employer until he sells his goods,—but through all the stages, from the first gathering of materials and the first fashioning of tools up to the final emergence of satisfaction-yielding "real" income, advances to workmen as a whole are made by the capitalists as a whole, and discounting takes place at each successive stage.

This discount we may assume (provisionally) to take place

[1] Compare Chapter 40, § 4.

at the current rate of interest. Evidently the simpler the processes, and the more predictable their outcome, and the more effective the competition among capitalists, — the closer will be the correspondence between future product and present wages. The discount then will be easy to calculate. Where the process is complicated, long-stretched-out, and uncertain as to its outcome, the relation between wages and product is a very loose one. Such an operation as the construction of the Panama Canal illustrates the maximum of uncertainty in the relation between product and wages. It will take years to build the Canal; it will take further years before its effects on the ocean routes and on the cost of transportation are worked out; and still further years before these changes affect the international division of labor and the ultimate increase of product due to increased geographical specialization. Meanwhile, those engaged on work at the Canal do not receive wages determined by the discounted value of the product of their own labor. They receive the current discounted value of similar labor in those routine industries where experience has indicated what the output will be. What is true of the Panama Canal is true, in some degree, of all new and venturesome operations. In such operations the business man exercises his most characteristic functions, and, if successful, procures his highest returns. He not only discounts, he speculates; and he pays to his laborers the rate of wages fixed in those operations in which the discount, on the basis of the current rate of interest and of the ordinary return to the ordinary business man for his own labor, is comparatively simple and calculable.

§ 6. Two qualifications must be borne in mind as to this reasoning: one with regard to the discount, the other with regard to the margin.

(1) It was assumed in the preceding section that the discounting takes place at the current rate of interest. Here we must be on our guard against reasoning in a circle. In previous chapters, interest has been accounted for, in part at least, by the fact that there is a "productivity" of capital; it results

from the application of labor in more productive ways. If this were the whole of the theory of interest, we should reason in a circle in saying that wages are determined by a process of discount. If interest depended simply on the excess of what the laborers produce in the future over what is advanced to them in the present, the rate of interest then would *result* from the process of advances to laborers; it could not also regulate or determine the amount of those advances.

But, as has also been pointed out in the previous chapters,[1] the conception of the "productivity" of capital explains only the demand price of capital. The conditions of supply, and the equilibrium of demand and supply, are also to be considered. If there is a regulator of interest in the way of a general or marginal time-preference, — a minimum return necessary to induce saving and accumulation on a large scale, — then and then only have we an independent determination of interest, and so a tenable theory of wages as the result of an operation of discount. The chief evidence which we have of such a fundamental supply price has been found in the steadiness of the rate of interest during the modern period. At all events, unless there be such a basic and independently determined rate of interest, the conception of discounting labor's product can lead to no consistent conclusion on the apportionment of returns between laborers and capital-owners.

(2) A competitive margin is assumed, at which the process of discounting is carried on with some approach to certainty. At that margin there is nothing in the nature of rent or monopoly gain; nor is there exceptional profit by a business man of unusual capacity. We suppose a representative firm, carrying on its operations at the margin of cultivation, securing for its owners and managers ordinary business profits and interest on capital, but nothing more. What is paid in wages here settles wages in the more profitable establishments also; and what is paid in wages here is settled by the process of discounting.

Here, again, the theory of wages connects itself with other

[1] See Chapter 39, especially §§ 4, 5.

parts of the theory of distribution. The distinction between interest on the one hand, rent and monopoly gains on the other, depends on the assumption of a competitive rate of return for capital, — on the existence of a broad *margin* where in the long run only those returns are secured which are necessary to induce the investment and management of capital. If there be no such margin, there is no ground for distinguishing between interest and the other returns to the owners of capital and land.[1] And if there be no such margin, there is no ground for saying that wages are in any determinate relation to the product of labor. If the return to the owners of capital is only a matter of accident, or the result merely of power in their hands, the amount which they will advance to laborers is subject to no controlling tendency. The most that can then be said is that the general rate of wages will depend on the relation between the number of the laborers and the amounts which the capitalists choose to advance.

There is doubtless a lessening range of competition in modern times. The margin is far from coextensive with the field of industry; rent and monopoly profits play a larger part than in previous generations. There is thus a wider divergence between wages and the total discountable product of labor. The concentration of the control of capital, aud the growth of combination and monopoly, suggest that competition may be in process of complete disappearance. If so, all our reasoning as to a normal rate of interest or a normal general rate of wages falls to the ground. Distribution then becomes nothing more than a struggle between hostile forces. But the same considerations which lead to the conclusion that there is a competitive region in which the return to capital *per se* is settled, lead to the conclusion that in this region the return to labor also is settled. A very large part, probably the larger part, of modern industry is still conducted under the leveling conditions of competition; and there is an approximation of wages, by way of discount, to the product at this margin.

[1] See Chapter 46, § 3.

§ 7. The fluctuations of wages above and below the general level determined by the discounting of the marginal product are much affected by the conditions under which the advances are made. Here, as elsewhere in the economic field, the working of the fundamental cause is obscured by the more superficial factors.

The employers pay wages in money. The money is used by the laborers in buying goods and services, — chiefly goods. Both the extent and the continuity with which money advances are made, and the state of supply as to the goods bought with the money, affect the fluctuations in general wages.

The store of things from which come real wages — that is, the goods bought with the money wages — reaches the laborer's hands through a flow; as indeed all income reaches consumers through a flow. We may use the simile of a reservoir, constantly drawn on, constantly refilled. The stocks of the retail dealers constitute the supply immediately available. Back of these are the stocks of the wholesale dealers; back of these, again, the goods in process of manufacture among the "producers." The very buildings and machinery may be said to contain — much as the raw materials do — the potentialities of future consumable goods. The whole stock of wealth in its various stages may be regarded, in the language of Böhm-Bawerk, as one great subsistence fund, of which a part only is available at once, the larger part being gradually made available by the steady pushing of the unfinished goods toward the stage where they are ready for enjoyment. So conceived, the whole mass may be described as a reservoir, from which the community is constantly drawing a stream of finished goods (and so of enjoyments), and into which its labor is constantly replacing what is drawn off.

The flow of finished goods or available real income is evidently elastic. The rate at which the reservoir can be tapped is subject to considerable variation. In one sense, the income of the whole community may be said to be predetermined; more cannot be got during a given period than the existing

apparatus of production is capable of yielding during that period. In a sense, too, the income of any particular class in the community may be said to be predetermined, in so far as the inflowing goods are already adapted to the traditional tastes of different classes. But there remains a considerable degree of adjustability, — more or less rapid flow, diversion of goods and materials toward one or another set of consumers, — and hence a response of real wages to variations in the money advances from the capitalists.

The money advances from the capitalist-employers, again, are affected by their expectations of gain. In times of hopefulness and activity, money wages will be paid out more freely, and the available supplies of goods will be drawn on with corresponding freeness. In times of uncertainty and depression, the movement will be a sluggish one. In good times, though prices usually advance faster than money wages, employment is more certain and constant, and real wages (commodity wages) on the whole tend to become larger. In the long run, the amount which can be drawn from the reservoir will depend on what the laborers put into it, as well as on the competition of the capitalists among themselves. The business men and investors secure between them the excess of product over and above what has been advanced to the laborers. If the excess is large, and if competition among employers and investors is active, they will be led (especially in brisk times) to make larger advances, and wages will gradually rise. If the excess, though large, is secured under conditions of monopoly, or with the use of limited natural resources, the capitalist class will reap extra gains; but wages will not be affected.

A high general rate of wages for hired laborers thus depends on general high productivity of industry — or, more precisely, on high marginal productivity — and on active competition among the owners of capital. Where laborers are not hired, but work for themselves, the relation between their reward and the productivity of their labor is obviously more direct and certain. The broad differences of wages which appear in

different countries are explicable by this main cause. If wages are higher in the United States than in England and Germany, higher in these than in Italy and Austria, higher in all European countries than in India, China, and Japan, the explanation is to be found in the varying productiveness of labor in the several countries. So it is with the great changes in wages from time to time. During the last half century there has been a rise in general wages (real wages) in all the countries of advanced civilization. The basis for that rise has been the steadily growing productiveness of labor, due to the manifold advances in the arts.

§ 8. Returning now to the conception of a discount, and to the relations between wages and interest, it is to be noted that a high absolute rate of wages usually is found where the proportion of total wages to total interest is comparatively small. The amount of income of the interest-receiving classes depends on the quantity of the advances made by them, and on the rate of the discount, — that is, on the rate of interest. With the same rate, their income tends to be larger as production becomes more "capitalistic," — that is, as it is spread over more time with the increasing use of plant and the increasing elaboration of materials. Just as discount figures more largely in the present value of a five-year note than in that of a one-year note, so interest figures more largely in a community where the period of production is long and the capital per laborer is large. The inequalities of income tend in this sense to become greater as total income becomes larger. True, within the capital-owning class itself, inequalities will not necessarily become greater; for the number of persons owning capital may increase as fast as its amount increases, and ownership may be no more concentrated. But the absolute amount of income going to this class tends to increase, and its share of total income tends also to increase; whereas for the laborers, though their total income may increase, their share of income of society as a whole tends to decline.

Hence it is that, on the whole, wages are high in those com-

munities in which the accumulation and investment of capital are great, and in which the total return to capitalists is large. Plant, machinery, huge collections of materials, an elaborate apparatus of production, are the means by which high productivity of labor is normally secured. It is true that in new countries other conditions may bring about high wages. Labor in them is likely to be confined largely to agriculture and other extractive industries in which virgin resources are turned to account and in which there is comparatively little use of elaborate fixed capital. Such was the situation of the United States during the first century of its history; such is that of Canada, Australia, New Zealand. But in old countries the cause by which high wages are made possible — a high productivity of industry — is that very employment of much capital which brings a large return to the capital-owning class. Great Britain has higher wages and a larger capitalist income than Germany; Germany has both larger than Austria or Italy or Russia; all the European countries have both larger than Japan, China, India. In general, the very forces which make the total income of society high and the general rate of wages high cause the proportion of income which forms return on capital to become large.

This tendency, inherent in the growth of capitalistic production, becomes accentuated in the degree to which there is departure from competitive conditions. Monopoly gains and economic rent also increase the proportion of total income which goes to the possessing classes. Such gains, even though they have not become so all-pervading as to wipe out the whole régime of competition, have become of wider extent in modern times. In the main, they, too, are large where prosperity is widely diffused, where the general productiveness of labor is great, and where the rate of wages is high. Like the growth of interest pure and simple, their increase is the consequence of large-scale production and of advancing population. They are more readily subject to regulation and curtailment than interest, and hence are not so inevitably the consequences of modern

industry. But some degree of accentuation in inequality seems unavoidable from this cause also. An enlargement of the leisure class and a diminution of the proportion of income going to the laborers are the natural concomitants of material progress under the system of private property.

§ 9. The doctrine stated in this chapter, that wages depend on the discounted marginal product of labor, will seem to many persons a dim and abstract one, remote from the problems of real life. Any theory concerning general wages must deal with distant forces and nebulous consequences; it has of necessity an appearance of unreality. Partly for this reason, many economists have refrained from undertaking a general statement. Yet this defect is inherent in almost all the doctrines on the ultimate causes of large economic phenomena. The same apparent lack of connection with the details of industrial life appears in the propositions that interest is determined by the relation between marginal productivity and marginal saving; that the quantity of the circulating medium determines the general ranges of prices; that the equilibrium of international demand determines the varying money incomes and price levels of different countries. All these propositions search out truths which are of direct and practical concern, even though they state tendencies which are slow moving and loom up indistinctly. Like the others, the doctrine here presented concerning general wages considers ultimate forces; and these are the very forces which must be scanned and weighed in any endeavors to raise the general rate. An all-embracing and considerable advance can come, under the régime of private property, only if productivity is increased, if the margin is keyed up, if the discount is narrowed by the accumulation and competition of capital. Everything that raises the productive margin, that lessens the rate of discounting, tends to raise wages; and in the last resort it is only in these ways that a general advance can be brought about.

Is there under these conditions the possibility of a large improvement in the condition of the mass of mankind? The

usual rate of wages for ordinary labor in the United States is now not far from $600 a year. This is much better than savagery, much better than what most men have been able to get at almost any time in any country. Yet it is much less than is needed for a life that seems to the more fortunate minority worth living. It gives little margin above the bare physical needs, little chance for leisure, for spontaneous activity, for culture, for full development of personality. If no more is in prospect, the institution of private property stands not only on the defensive, but in a position that cannot long be defended. Yet something better is by no means incompatible with the system. We may hope for a gradual rise in general wages, under the influence of the forces considered in the preceding pages, above all from the forward march of the technical arts. Great as the advance of the arts has been during the last century or two, it may be even greater during the centuries to come; and the main strength of the individualist and capitalist system is that it promotes industrial progress more effectively than the rival system of collectivism. It is at least an open question whether it will not bring in time a diffusion of comfort and economic security among the masses greater than can be attained under any other form of industrial organization.

That this end may be attained, it is necessary, first, that very considerable modifications shall be made from the traditional rules and limits of the system of private property; and second, that the numbers of the manual laborers shall not increase so fast as to swallow up all the possibilities of gain. The first of these conditions will be considered in the two later Books, on Problems of Labor and of Economic Organization. The second will be considered at once, in the chapters immediately following.

CHAPTER 52

Population and the Supply of Labor

§ 1. The supply of labor depends on the increase in the numbers of mankind. The problems concerning the growth of population bear not only on the distribution of wealth, but on other parts of economics also, not to mention wider social questions; and there is divergence of practise among economists as to the place which they should have in the exposition of the subject. Population is considered in this book at a later stage than is often assigned to it. Although discussed in the following pages mainly in connection with the theory of distribution, it will lead to some digressions from that topic.

A long controversy has been carried on regarding the Malthusian theory. In the early part of the nineteenth century[1] Malthus set forth that the cause of low wages and of poverty lay in the large numbers of mankind; that there was a tendency of population to press upon subsistence and keep wages low; that a rise in wages could not take place unless the tendency to increase among the laboring classes was checked; that in the absence of a check no plans for improvement in the condition of the mass of men had any prospects of success; and that for these reasons all proposed reorganizations of society were doomed to failure. Moreover, Malthus was not hopeful that any salutary check would in fact be applied. It cannot be said that he was hopeless; but the drift of his teaching, and certainly the point of view of his followers, was that the number of laborers was likely to increase very rapidly and that wages would probably be kept down to a subsistence level.

[1] The second edition of the *Essay on Population* (1803) is that in which Malthus stated his doctrines in the form in which they continued to be maintained by him and his followers.

In this state of facts he found a serious obstacle, almost an insuperable obstacle, to any great improvement in the material welfare of the mass of mankind.

Some parts of Malthus's teaching have been sustained by the course of thought since his time. Man is an animal, physiologically like any other; and the possibilities of his increase in numbers are as unlimited as they are for any form of life. It is an odd circumstance that Darwin, reading Malthus's Essay, was led to the reflection that not man only, but any sort of creature, has the possibility of indefinite increase; and hence reached the conclusion that there is an unceasing struggle for room and sustenance, and a survival of those best able to cope with their surroundings. Darwin's own wider conclusion then reënforced Malthus's views as to the human species. The elephant can double his numbers every one hundred years, man every twenty-five years; cats can bring forth sixfold twice or thrice a year, and fishes can reproduce hundreds and thousands of their kind each season. Any species that multiplies at its maximum rate must eventually outrun the means of subsistence.

§ 2. Let us look more closely at the possible increase in human numbers and compare it with the rates of increase which we actually find. The possible increase must depend on the possible excess of the births over the deaths. The maximum birth rate in a normally constituted population is at least 45 per 1000; that is, for every 1000 living persons there may be as many as 45 births each year. If a population were made up solely of men and women of the reproductive ages, the rate might be for a brief time very much higher. If a population contained merely an abnormal proportion of persons of these ages (as is the case in regions where there is a steady influx of able-bodied immigrants), the rate again might be considerably higher. Even for a normally constituted population, with the due proportion of children and aged, the figure 45 is below the physiological maximum. That maximum is probably as high as 50 per 1000, possibly higher. For the present purpose, that of comparing possible increase with

actual increase, it will be best to take the figure which certainly can be reached, — say 45 per 1000 in each year.

On the other hand, the minimum death rate is certainly as low as 15 per 1000 each year. Here, too, a normally constituted population must be assumed. A population having an undue share of persons in the prime of life would easily show a lower death rate; while one having — say as the result of emigration of the able-bodied — an undue share of very old and very young would hardly be able, even under the most favorable conditions, to show a rate so low. In a normally constituted population a rate as low as this is certainly possible. Some such figure as 15 per 1000 would be found if all preventible causes of death were done away with; if there were no deaths from curable diseases, and none due directly or indirectly to poor nourishment, insufficient care, insanitary surroundings; if the end came only in peaceful old age, or from disease which could be prevented by no care and no medical skill. Indeed, if all these possibilities were realized, the rate would certainly be lower. There are populations in which a rate nearly as low is, in fact, found; and it is certain that in these there are many deaths which could have been prevented. Medical science, moreover, is rapidly advancing. It has very greatly lowered during the past generation the death rate from infectious and contagious diseases; it may reduce as markedly that from the organic and degenerative diseases which are most fatal for adults. The minimum death rate may be expected to become lower and lower.[1]

No race or country concerning which we have accurate information exhibits either the maximum birth rate or the mini-

[1] Newly settled regions, and rapidly growing cities, into which persons in the prime of life are flocking, show death rates as low as 12 or 13 per 1000. These rates are sometimes paraded as evidence of unusual healthfulness, they are due (when not explained by inaccuracy of the figures) to the absence of the normal proportion of children and the aged, among whom mortality is greatest.

It is reported that in New Zealand a death rate of only 10 per 1000 was found during a ten-year period (1887–1896), and was not accounted for by any very exceptional age distribution (Newsholme's *Vital Statistics*, p 88). Such a rate is extraordinarily low, and raises suspicion of defective counting.

mum death rate as here stated. But for the broad conclusions with which we are concerned, it is not necessary to be precisely accurate as to these extremes. It suffices to indicate how wide is the possible variation between the birth rate and the death rate, and how great is the possible increase of population. If births are 45 per 1000 annually, and deaths but 15 per 1000, the excess of births over deaths, or increase of population, is 30 per 1000. With this rate of increase, numbers will double every 23 years. Malthus himself deduced a similar possible rate of increase from what he found, or thought he found, in an actual case. "In the Northern states of America . . . the population has been found to double itself, for above a century and a half successively [that is, from about 1650 to 1800], in less than twenty-five years." Malthus thought that an increase even more rapid might take place, and that the doubling period might be as low as fifteen years. This probably exaggerates the potentiality of increase. But it is certainly within the bounds of possibility that the numbers of mankind should double within such a period as has just been indicated, — in a quarter of a century or thereabouts.

Not only is there a possibility of so rapid an increase as this; there is a tendency toward it. By tendency here we do not mean what is often meant by the term, — probability that in the long run a given result will be reached. This is the sense in which we can say there is a tendency that commodities, freely produced, will sell for a price determined by their expenses of production. In speaking of the tendency of population to increase at its maximum rate, we mean something different, — that there are forces in operation which, unless counteracted, will bring about the given result. In the same way we say that there is tendency for all bodies to fall to the earth; not that they are in fact likely to do so, but that they will unless something prevents. The tendency of population to increase results from the reproductive instinct and the love of parents for their offspring. These are universal and powerful forces. They operate without restriction among animals.

Each species of animals tries to multiply at its maximum; tries, that is, in the sense that it will do so unless by an intervening cause numbers are kept down.

But no species of animal can, in fact, increase at its maximum rate. If it did so, it would in time crowd out all others and alone would occupy the earth. Nor is man an exception. A continual doubling of his numbers every quarter of a century cannot take place. Only under exceptionally favoring circumstances can such a rate be long maintained. When a civilized population, having the tools and the knowledge acquired during slow centuries of growing civilization, suddenly comes into possession of a new country, it finds for a while limitless room for growth. Such was the situation in the North American colonies during the period to which Malthus looked for an example of the possibilities of increase. Such has been the situation of the people of the United States during the greater part of their history, of the Canadians, the Australians, the Argentines. These are rare cases in the history of the human species. They are analogous to the comparatively rare cases where a new animal — a moth, a bird, a mammal — migrates into a country hitherto strange to it, and can multiply for a while without finding its food scarce or its enemies too strong. In any long-settled country mankind cannot increase at anything like the maximum rate. The fundamental reason for this is to be found in the tendency to diminishing returns from the soil. On any given area, that tendency shows itself for all agricultural produce. It may be counteracted in some degree by improvements in the arts. But a continuous doubling of numbers every quarter of a century must eventually encounter the obstacle of increasing difficulty in securing the food supply.

The tendency toward increase in population must then be counteracted; and it may be counteracted in two ways, to which Malthus gave the names positive and preventive checks. By positive checks he meant those which cut down numbers already brought into the world, — starvation, disease, war, misery in all its forms. By preventive checks he meant those

which prevent numbers from being brought into the world. The first operate through a high death rate, the second through a low birth rate; in other words, the first through an excess of deaths, the second through a limitation of births.

It would not be going very far astray to say that the extent to which one or the other check prevails is a test of the advancement of civilization. The question is, to be sure, not one of yes or no, but one of more or less. Mankind rarely exercises the power of reproduction to the full. Some limitation of births appears in every society which has progressed beyond the very lowest stage. As civilization advances, more and more forethought is exercised. Among all peoples, there is some operation of the positive check also. Except among a small stratum of the well-to-do, more beings are brought into the world, even in the most advanced countries, than can survive Numbers are kept down in part by a death rate needlessly high, — that is, a death rate above the minimum from old age and irremediable disease. The more there is limitation of births, the higher is the plane of civilization; the more excess of deaths, the lower.

§ 3. With these general principles in mind, let a look be taken at the birth rates and death rates found in our own day in some of the principal countries. In the following table the maximum birth rates and minimum death rates are first given, for ready comparison; then follow figures for the rates in some selected countries. The "doubling period" means the number of years in which population would double if the given excess of births were steadily maintained.

Note the wide divergences in the birth rates. Roumania and Hungary and Saxony have rates not very much below our supposed maximum. Other countries have markedly lower rates. France, which comes at the bottom, has a birth rate about one half that of Roumania and Hungary. On the other hand, there are divergences almost as striking in the death rates. The death rate in Roumania and Hungary is nearly 30 per thousand, or twice as high as the minimum. At the lower

BIRTH AND DEATH RATES

ANNUAL AVERAGES PER 1000 OF POPULATION, FOR THE PERIOD, 1891–1900

	BIRTHS	DEATHS	EXCESS OF BIRTHS	DOUBLING PERIOD (IN YEARS)
Maximum and Minimum	45 (*Max.*)	15 (*Min.*)	30 (*Max.*)	23
Roumania	40.7	29.3	11.4	61
Hungary	40.6	29.9	10.7	65
Saxony	39.5	24.0	15.5	45
Bavaria	36.5	25.4	11.1	62
Italy	34.9	24.2	10.7	65
England and Wales	29.9	18.2	11.7	59
Sweden	27.2	16.1	11.1	62
France	22.2	21.5	0.7	990

end of the list, the death rate sinks to much more moderate figures, — little above 20 per thousand for France, and noticeably below that figure for England and Sweden.

In general, a high birth rate is accompanied by a high death rate. Such is the case with all the countries in the upper part of the list, — in Roumania, Hungary, Saxony, Bavaria, Italy. This correspondence of high birth rates with high death rates means that Malthus's warnings and foreboding are applicable. Here are countries in which population is pressing on subsistence. It is trying to increase faster than the means of support make possible, and the positive check is in operation. Not the positive check in its most extreme form; the birth rate is not at the maximum; some limitation of births there is. But more children are born than can survive and become adults, and more persons become adults than can survive to peaceful old age. The populations are ill fed, ill clad, ill housed, ill warmed, ill cared for in sickness. Hungary and Roumania are in the worst case; Saxony, Bavaria, and Italy are in a bad case. In all these countries, an indispensable condition for a permanent improvement in the condition of the mass of the population is a lowering of the birth rate, — a relaxation of the pressure on the means of support.

In such countries, the death rate is always highest among the very young. Under the best conditions, the period of childhood is one of great sensitiveness to physical ills. Even where the general death rate is very low, as in the Scandinavian countries and in some Australian states, ten per cent of the children die before completing the first year of life. Between ten and fifteen per cent die in England, France, and Massachusetts and New York. Twenty per cent and more fail to live one year in Austria and Hungary, twenty-five per cent in Russia; there are extreme cases where one third of the babies have died. Again, taking the children under five years of age, we find that out of every 1000 born, there died before attaining the age of five:[1] —

in Bavaria	393
in Austria	389
in Italy	378
in France	251
in England and Wales	249
in Sweden	222

A high death rate among children, such as appears in the countries having the high birth rates, means simply that babes are brought into the world who cannot survive. It means suffering, with never a chance of a happy outcome. Those children who do survive and grow to mature age must face low wages and hard conditions of life; yet they in turn marry early and procreate freely. The round of misery goes on without ceasing.

Consider now some of the other countries. Note first that the rate of increase — the excess of births over deaths — is quite as high in England and Sweden as in the other countries. It is about 11 per 1000 annually. But both birth rates and death rates are lower in Sweden and England. Though the birth rates

[1] Figures of this sort can be found in any book on vital statistics. Those here cited may be found in Newsholme's *Vital Statistics*, p. 130 (taken from Bertillon), Bailey's *Modern Social Conditions*, p. 224, and the Massachusetts Registration Reports. For a comparative survey, with figures for the United States, see E. B. Phelps, in *Publications American Statistical Association*, December, 1910.

are higher in Hungary and Bavaria, their populations are not in fact increasing faster. They are trying to increase, but are kept down by the positive check. In England and Sweden the people are not trying to increase so fast; the birth rate is lower; the preventive check is in operation to a greater degree. Obviously, the condition of England and Sweden is much the happier. They escape an immense amount of avoidable suffering. If their birth rates were to rise to those of the other countries, their death rates would almost surely go up in some corresponding degree. Numbers would not increase more rapidly, but would simply be prevented from increasing through a different and more miserable process.

The fact that population advances with some rapidity in these happier countries, and yet does not bring with it high death rates, is accounted for in various ways. In Sweden it is due chiefly to emigration. Such figures do not necessarily state what is the actual gain in numbers in the several countries; they indicate only what gain would have taken place by internal growth. The final effect on numbers depends also on the inflow and outflow, — on immigration and emigration. The emigration from Sweden during the period under consideration was large relatively to the population. Except for this, either the death rate would have been higher or the birth rate lower; for Sweden is not a country with such possibilities of expanding production as to enable its numbers to grow as they would have done by natural increase alone. It is to be noted that some of the other countries also have found an outlet in emigration, — notably Italy. Had it not been for a great stream of emigration, Italy also would have had a death rate even higher than that which she shows; or else her birth rate would have been smaller.

England, too, has found some outlet in emigration; but not to a great extent during the decade to which the figures apply. In the main, her excess of births over deaths has meant an actual increase of the numbers in the country. Numbers have been able to grow, because England's powers of production have

kept pace with them. This could hardly have been the case if England had supported them and supplied them with raw materials from her own soil. But she is a great manufacturing country, obtaining food and materials in exchange for exports of manufactures as to which there is no obstacle from diminishing returns. Exchange of this kind was the basis of England's advance in population and wealth during the nineteenth century. So long as it continues, and continues for expanding numbers, she can maintain a high birth rate and yet a low death rate. When growth of this sort slackens, — when it becomes more difficult to buy ever increasing food supplies by exporting manufactured goods, — England must have either a lower birth rate or a higher death rate. The former alternative will almost certainly be chosen; indeed, a slackening in the rate of growth has already shown itself. As will appear more fully in the sequel, this is the mode in which the populations of all the advanced countries are likely to accommodate themselves to conditions of greater pressure.

France is the classic country of the preventive check. Her population has been practically stationary for two or three decades; or rather, it has failed to grow by natural increase. Such slight gain in total numbers as appeared has been due to immigration. The death rate in France is not as low as it might well be. In part, it is true, her comparatively high death rate may be accounted for by the mere fact of her population having been for some time nearly stationary. This brings about an age distribution with a comparatively large number of older persons, among whom the death rate must be higher. But it is also true that France, though a great and prosperous country, yet has — what country has not? — strata in her population, both industrial and rural, in which the conditions of life are hard and the deaths are largely due to preventible causes. None the less, her birth rate on the whole is low, and her population does not press hard on her resources. Especially in the rural regions, the population of France is eminently thrifty, self-respecting, careful of the future; not in every

respect in a condition thoroughly satisfactory, but vastly happier and more prosperous than that of Italy, Hungary, or Saxony.

For the United States as a whole, trustworthy figures of births and deaths are lacking. The Census authorities state a birth rate of 35.1 per 1000 for this country in the decade 1890–1899, and a death rate of 17.7. But both figures are open to suspicion. The death rate is stated on the basis of inadequate census returns; and the birth rate rests on complicated calculations, in which the uncertain death rate enters. It is to be expected that a country whose opportunities for economic growth are such as the United States possesses, should have a high birth rate; while general prosperity and ease would lead one to expect a relatively low death rate. But the United States is a very heterogeneous country, and any general averages for its vital statistics, even if based on accurate figures, would be of uncertain significance. The birth rates, for example, of the colored population, especially in the South, are high; the death rates here are also high. The colored population is in a condition analogous to that of Roumania and Hungary. The white population of the South also has a high birth rate, and a comparatively high death rate, though by no means so high as that for the negroes. In the Central and Western parts of the country the birth rate probably is relatively high, the death rate low. In the Eastern states, and especially in New England, the birth rate is comparatively low. Thus in Massachusetts, in which state alone accurate registration has been continuously maintained, the birth rate has been for some decades not far from 25 per 1000. The death rate in that state has been low, from 17 to 19 per 1000.[1] But here again the population is not

[1] The birth rates and death rates in Massachusetts have been as follows, arranged for quinquennial periods:—

	Births	Deaths
5 years ending 1880	24.2	18.8
5 years ending 1885	25.0	19.8
5 years ending 1890	25.8	19.4
5 years ending 1895	27.6	19.8
5 years ending 1900	27.0	18.0
5 years ending 1905	24.2	16.4

homogeneous, and the figures need to be interpreted. Massachusetts has had a steady inflow of immigrants; hence her population includes an unusual proportion of people in the prime of life, which in part accounts for the low death rate. On the other hand, there is a marked difference between the foreign born and the native born. The birth rate is very much higher among the foreign born; while among the native born it is remarkably low, — a phenomenon of which more will be said presently. The variations between different parts of the United States are as great as those between different European countries.

§ 4. High birth rates, high death rates, backward industrial conditions, low wages, — these commonly go together. But which is cause and which is effect? The unqualified Malthusian view is that the pressure of population, indicated by a high birth rate, is the cause from which all the evils flow, and that the one effective mean of improvement is a lowering of the birth rate. But the situation is not quite so simple as this.

High birth rates and misery are largely interacting causes. A high birth rate commonly means, in an old country, misery; and misery, in turn, often increases the birth rate. When a people is poor and sees no prospect of escape from poverty, it is in danger of becoming demoralized. Multiplication takes place without thought of the future, since the future seems in any case without hope. That very multiplication shuts the door to hope. In modern times, such a fatal round of interacting causes often appears in manufacturing districts where there is much employment of women and children: as, for instance, in the textile districts in Saxony of which Chemnitz is the center. There women and children offer themselves for employment because people are many and wages are low. The very opportunity for securing employment, on the other hand, promotes multiplication, since the income of the family is eked out by the earnings of mother and offspring. Where such conditions have established themselves, the way of escape to something better is hard to find. The causes of demoraliza-

tion and misery become cumulative. Even in countries where the general conditions are good, there is commonly a low-lying stratum of the population in which there are high birth rates, high death rates, pressure for employment, low wages, — connected phenomena, yet no one the certain cause of the other.

None the less, it is clear that restraint on the increase of numbers is one essential condition of improvement. Stated in this way, the Malthusian proposition is impregnable. A limitation of numbers is not a *cause* of high wages, but it is a *condition* of the maintenance of high wages.

High wages depend fundamentally on high productivity of industry. In new countries, where the increase of population is not confronted by limited natural sources, and where capital also increases rapidly, the laborers may multiply fast without having to face harsh terms. A long period may elapse before signs of pressure appear. But in countries already well peopled, the fundamental limitation from diminishing returns on land is ever present. Unless there be some exercise of the preventive check, no measure toward general improvement can be effective.

But mere exercise of the preventive check can accomplish nothing. Only if there be the other conditions needful for prosperity — improvements in the arts, increasing capital, greater productivity of industry — will the general social income, and wages as part of that income, show a tendency to rise. Then restraint on multiplication, though not in itself a cause of gain, will enable the gain to be maintained. It is certain that if population increases at its maximum rate, or anything like that maximum, high birth rates will bring not only high death rates, but low wages also. But if there be forces in operation which raise the productivity of industry, a lowered birth rate will enable more favorable conditions to be attained and held.

§ 5. The standard of living is often spoken of as the fundamental cause determining wages. There is a sense in which it is a fundamental cause. Yet it acts, not directly, but through its effects on numbers. A high standard of living does not in

itself increase wages. It may serve to lower or to keep low the birth rate, and thereby create one of the conditions on which the maintenance of high wages usually depends. But unless the other conditions are present,—a large demand for laborers, which comes at bottom from a large productiveness of industry, —a high standard of living brings nothing to pass.

There are curious fallacies on this subject. A notion is prevalent among many workmen of the upper tier (mechanics and the like) that cheap living is bad for them and free expenditure good. They suppose that if they economize (use cheaper food, for example) advantage will somehow be taken of them and their wages reduced; whereas if they "live well," that their wages will be kept up. Hence persons who propose economical ways of using and cooking materials for food are suspected of being in a covert conspiracy to bring down wages. Nothing is more irrational. Every way of getting as much as possible with your income — of so directing expenditure that the maximum of utility is secured for each outlay — serves to increase the effectiveness of the forces which make for prosperity. What the laborers get depends in no direct way on what they spend, or on their standard of expenditure. It depends on their numbers as one factor; and the standard of living has an effect on their wages only in so far as it has an effect on their numbers. Some economists have been no less guilty of confusion on this topic than the laborers themselves. They have discussed the standard of living as if it were a force acting directly; whereas it acts only indirectly.

This proposition, like so many others in economics that are essentially true, needs some qualification. It is true that a high standard of living exercises an influence on wages chiefly through its effect on numbers; yet it does have some effect also on the bargaining process. The first step in the settlement of the wages of hired laborers is a contract with an employer. All sorts of factors bear on the contract; not only labor organizations,—of which more presently,[1]—but established tradi-

[1] See Book VI, Chapter 55.

tions as to what are "fair wages" or "living wages." These are vague and often question-begging phrases; men's notions of what is just pay or living pay are usually settled simply by the rate to which they are habituated. But the fact of habituation counts as one of the elements in bargaining. An established standard of living will cause workmen to stick more stubbornly to a demand for what they regard as decent wages. Within the debatable ground subject to the higgling of the market, a high standard of living thus may have some direct effect on the outcome.

Though a high standard of living, showing itself in a lowered birth rate, establishes itself with difficulty in a population steeped in poverty, the difficulty of raising the standard is not so great as many of the older writers supposed. They thought that a real advance could come only by some sudden uplift, giving time for the establishment of new habits. From this point of view, the outlook gave little hope, for nothing is more difficult to bring about than a sudden great change in social and material conditions. Happily, this opinion has been shown by the course of recent history to be unfounded. During the last generation, there has been in the more advanced countries a slow and gradual improvement in welfare, and with it a slow and gradual fall in the birth rate. All tne leading countries show a declining birth rate, side by side with a death rate declining still more. The change is most unmistakeable (as will presently appear) among the well-to-do, but it appears also in the upper strata of the workingmen, and, though more faintly, among the lower tiers of the laborers. It is gradually affecting all classes and all countries. It is both a cause and a result of greater prosperity, and both a cause and a result of a higher standard of living. It bids fair to have more and more important consequences as time goes on.

§ 6. The birth rate in all civilized countries has shown a decline since the middle of the nineteenth century. Thus in England it was 35 per thousand in the decade from 1850 to 1860; in 1900–1905 it was about 27 per thousand. In France

during the same period it has gone down from 26 per thousand to 21. In Germany the decline has been less striking, but none the less unmistakeable, from 36 or 37 to 33 or 34. There is evidence that a similar change went on in the United States through the nineteenth century.[1] In other words, there has been an application of what Malthus called the preventive check. But the change has taken place by a process different from that which Malthus recommended and expected. Malthus desired that the time of marriage should be postponed and that marriages should take place at a later age. Were this done, the marriage rate would decline; and the birth rate then would also decline, both because of the shorter duration of the period of fertile married life, and because of the less fertility of the later age periods. In fact, however, the fall in the birth rate has come about with a marriage rate nearly stationary. The fall in the birth rate has been in the main the consequence, not of a smaller proportion of marriages to the total population, but of a smaller number of children per marriage. The marriage rate in most countries, though it shows a slight tendency to decline, has varied little. It is usually not far from 8 per 1000. It is very nearly the same in France, in Germany, and in England; yet these countries have very different birth rates. The number of children per marriage, varying though it does from country to country, tends to be smaller in almost all countries; unless indeed, as in France, it has reached a minimum where it just balances the number of deaths. There is no question that this general situation — marriage rates virtually stationary and yet declining birth rates — is due to deliberate abstention from propagation. Married couples have fewer children than before, by deliberate intent. The tendency is

[1] Figures on this subject can be found in any statistical compendium. For a careful discussion and selected figures, see Mayr's *Statistik und Gesellschaftslehre*, Vol. III, pp. 113–114; and for the United States W F Willcox's paper in the *Publications American Statistical Association*, 1911, No. 2. Professor Willcox has brought out the surprising fact that the decline in the United States has not been of recent origin, but has gone on continuously since 1800. See also two admirable papers, one by Messrs. Newsholme and Stevenson, the other by Mr. Yule, in the *Journal Royal Statistical Society*, 1906, pp. 34, 88.

more marked in some countries than in others; more marked, for example, in Protestant countries than in Catholic. It appears among the well-to-do more unmistakeably than among the poor, yet it is spreading to all classes. It raises some large questions, both as regards the general problems of population and as regards those of social stratification. To these questions we shall turn in the next chapter.

CHAPTER 53

POPULATION, *continued*

§ 1. Between the several social classes or non-competing groups there are variations in birth rates and death rates no less marked than the variations between different countries. Such differences within any one country are even more significant than the differences between countries, for they bring into fuller light the nature of social stratification and the connection between standards of living and ruling rates of income. The statistical evidence on this part of the subject is comparatively meager; on the other hand, the observation of everyday life goes far to make plain the general situation.

First, consider the nature of the statistical evidence. Marriage takes place later among the well-to-do classes than the workingmen. The average age at marriage of bachelors and spinsters (*i.e.* for first marriages) was found to be in Great Britain, in 1890:[1] —

	BACHELORS	SPINSTERS
Miners	24	22.4
Artisans	25.3	23.7
Shopkeepers	26.6	24.2
Professional and independent classes	31.2	26.4

Another indication of the same situation is found in the fact that, in Great Britain at the same date, out of every 1000 miners who married, 704 were under 25 years of age, while out of every 1000 persons of the professional and independent classes only 151 were under 25.

[1] The often-cited figures of Ogle, in *Journal Royal Statistical Society*, 1890, pp. 274–275.

The later age of marriage in itself tends to bring a smaller birth rate among the well-to-do. But the birth rate is smaller to a degree far beyond what is explained by this circumstance alone. The discrepancies between the social classes are striking. In Berlin a recent elaborate examination has shown that the married women in the poorest quarters had nearly twice as many births as those in the richest, and that the inverse relation between birth rate and prosperity held throughout the scale. For every 1000 married women of child-bearing age (15–45) there were in 1900: —

236 births in the poorest quarters
212 births in the next poorest quarters
191 births in the next poorest quarters
180 births in the next poorest quarters
161 births in the next poorest quarters
127 births in the richest quarters

It is not often that direct comparison of this kind (between the number of married women and of births) is feasible. But it has been frequently shown that the number of births is large for the poor, small for the rich, in comparison with the total number of women (married and unmarried) of child-bearing age. This result appeared for all the German cities from the investigation just referred to; thus, to take one example, in Hamburg the births per 1000 women of child-bearing age (15–45) were 59 in the richest quarters, 151 in the poorest quarters. An older and much-quoted set of figures for various European cities gave the number of births (per 1000 women aged 15–50) thus: —

	Paris	Berlin	Vienna	London
Very poor quarters	108	157	200	147
Poor	95	129	164	140
Comfortable	72	114	155	107
Very comfortable	65	96	153	107
Rich	53	63	107	87
Very rich	34	47	71	63

In Boston the average birth rate for the whole city was, in 1900–1904, 27 (per 1000 inhabitants); in the ward inhabited chiefly by the rich it was only 13 per 1000; in wards of the poor it was from 28 to 36 per 1000. In the ward where the newly arrived Italians cluster, it was 46.[1]

It is part of the same phenomenon that in the United States the birth rate is much lower among the native born than among the foreign born. The native born are on the whole those of larger incomes and better social station. In Michigan, for a period of 25 years, from 1870 to 1895, the number of children per 1000 women between the ages of 15 and 45 was for the native-born women about 120 (ranging from 111 to 127) and for the foreign-born women about 230 (ranging from 221 to 235).

Similar figures as to varying death rate are not easy to get; but they are not needed to show the salient facts. The higher death rate among the poor, especially for infants and children, is too sadly familiar. Every poor quarter swarms with children, and in every poor quarter the chance of survival to maturity is less than in a well-to-do quarter.[2]

These variations are the evidences and the consequences of differences in the standard of living; and they bear the same relation to the standards of living among social groups as the similar variations do to the standards of living in different countries. The reason for low remuneration in any given group is that the numbers in that group are large relatively to the demand for the services yielded; in other words, because

[1] The figures as to Berlin and Hamburg are from Mombert, *Studien zur Bevölkerungsbewegung in Deutschland*, pp. 149, 150. An excellent survey of all the evidence on this subject for various countries is given in Mombert's book. The figures for Paris, Berlin, etc., are Bertillon's, in the *Bulletin de l'Institut Internat. de Statistique*, Vol. XI, Part 2, p. 163; those as to Boston from Wolfe, *The Lodging House Problem in Boston*, p. 128. Figures such as Bertillon's exaggerate the differences, because rich quarters contain many unmarried women servants, whose presence brings down the birth rate in comparison with the total number of women of child-bearing age.

[2] The following figures are for London in 1903. They give the birth and death rates by groups of the population of London, Group 1 being the poorest, Group 6 the richest (the test of riches and poverty being in this case the proportion of servants kept). Both crude and corrected rates are given for births and for deaths; the crude rates being per 1000 of population, and the corrected

the marginal utility or efficiency of the group's members is low.[1] But the numbers in any group remain large or small according to multiplication within the group. Not solely, it is true, according to this factor; there is transfer from group to group, and especially some swelling of the numbers in the higher ranks through inflow from the lower. Yet in the main each group is recruited from its own members. Certainly in the lowest of all, that of unskilled laborers, growth proceeds almost wholly from within. The wages of day laborers are low because there are so many of them; and there are so many of them because, notwithstanding low wages, they continue to marry and multiply, and, as a rule, marry early and multiply fast.

Here, again, the relation between standard of living and wages is not direct, but indirect. The mere fact that the well-to-do are habituated to comfortable living, and wish to maintain comfortable living, does not make earnings large. But the fact that there are comparatively few physicians, lawyers, architects, engineers, business men of the upper tier, — this serves to keep high the incomes of the class. The wages of common laborers are not low because they are used to coarse food and cheerless living; it is the maintenance of their numbers in face of these meager conditions that keeps wages low. There is a correlation between standard of living, birth rates, supply of workers, and, finally, earnings.

rates taking account of variations in marital conditions and of the distribution of the population by age groups.

	Crude Birth Rate	Crude Death Rate	Corrected Birth Rate	Corrected Death Rate
Group 1 (poorest) ...	35.0	18.4	31.6	19.1
Group 2.............	38.3	14.4	25.8	15.0
Group 3.............	26.0	14.6	25.6	15.3
Group 4.............	25.9	12.1	25.5	12.7
Group 5.............	25.1	14.8	25.3	15.5
Group 6 (richest).....	18.2	13.0	20.4	14.6

See the paper by Newsholme and Stevenson, already referred to, in *Journal Royal Statistical Society*, 1906, p. 71.

[1] See above, Chapter 47, §§ 1, 2.

It is possible to conceive of the standard of living as not only influencing wages through the ultimate effect on numbers, but as fixing wages at a precise point, — as having a determinative influence similar to that which cost of production has upon the long-run value of commodities. Thus a given group — say that of the upper set of manual workmen, the mechanics and skilled craftsmen — may be supposed to have a specific standard of living, to multiply fast when earnings exceed the amount so defined, and to check multiplication when earnings fall below it. But such a conception of the situation is true to the facts only in a very vague and uncertain way. Other circumstances than a foreseen and calculated rate of remuneration affect marriages and births. The influence of the purely economic motives is irregular, often only half-conscious. They are more likely to serve in checking multiplication than in increasing multiplication; they are more likely to keep wages from declining than to prevent them from rising. When a moderate increase of wages in a given group is made possible by greater demand for its services, it is not to be thought probable that higher birth rate and internal growth will check the advance. It is much more likely to be kept within limits by seepage from without, — by the success of some individuals from other groups in finding their way into the more prosperous employment. Not only for the population at large, but also for the several classes within it, it is safer to say that a high standard is a condition of the maintenance of high earnings than that it is a cause.

§ 2. The general decline of the birth rate in advancing countries; the accentuation of that decline among the well-to-do; the probability, almost certainty, that with wider diffusion of prosperity the tendency will spread more and more to all classes, — all this is due to social and industrial ambition. Some writers have discussed the change as if it were automatic, as if the lower birth rate among the well-to-do were the natural and necessary consequence of their having a larger income. The connection between income and birth rate is the other

way; rising prosperity is rather the effect than the cause of declining pressure. The fundamental cause is the wish of each family to promote its own material welfare. Malthus spoke of the desire of each individual to improve his condition as the *vis medicatrix* of society. Certainly with reference to the growth of population, he spoke with truth. When some chance of better conditions is visible; when a better-paid occupation, education, some savings and some accumulation appear within reach; when it is seen that more mouths to feed mean a lessening possibility of utilizing such an opportunity, — then the propensity to multiplication is more and more held in check. The causes of the declining birth rate are to be found in the intellectual and material forces which have so wonderfully stirred the people of western Europe during the last century: the spread of education, newspapers and books; cheap movement by railway and steamship; the stirring of stagnant populations by the new modes of employment, by large-scale production and the factory system, by the changes through emigration. Not all of these forces have been steadily at work in the same direction. The factory system has seemed at times simply demoralizing, though in the long run it also has had an awakening and uplifting effect. Where the ownership of land has been widespread, or the conditions of tenure secure, the agricultural population has responded most surely to the new opportunities, as in France, the United States, western Germany. Where the agricultural workers are divorced from the land, as in eastern Germany, England, southern Italy, Austria and Hungary, they have needed a stirring from the other world, through emigration, to rouse them to the outlook for improvement. Throughout, it has been awakened ambition in the individual that has caused the standard of living to rise.

Malthus was induced to write on the question of population because he believed that here was an insuperable obstacle to utopian schemes. His followers steadily maintained that the tendency of population to outrun subsistence was an obstacle

in the way of socialism. The obstacle may not be insuperable; but it is certain that in a socialistic society it will have to be overcome in a way very different from that which has in fact appeared in modern communities. On the one hand, inequality and the familiar spectacle of a higher economic and social stratum; the stimulus of self-interest, on the other hand, for one's self and one's children, — these are the factors which have limited the movement of population, spurred ambition and imposed restraint, and so sustained the advancement and diffusion of material well-being. Individualism is at the root of the phenomenon.

All these individualistic forces have been most strongly at work in the United States. Nowhere has there been more freedom of opportunity, more spur to individual ambition, more stirring from education and from the consciousness of larger possibilities. Hence it has happened that, in those parts of the country and in those social strata where the pressure of advancing population portended danger, pressure has begun to relax.

In New England, for example, the native-born population has long been multiplying at a very slow rate. The gross increase in the population of New England has indeed continued to be considerable; but the increase has come by the steady inflow of immigrants and by the large birth rate of foreign-born parents. The striking difference between the fecundity of native women and foreign-born women has already been noticed with reference to Michigan. In Massachusetts it is even more striking; the birth rate among the foreign born is three times that among the native born, as the following figures show:[1] —

ANNUAL BIRTH RATES

	1883-1887	1888-1892	1893-1897
Native parents..................	17.1	17.1	17.0
Foreign-born parents.............	48.4	49.6	52.1

[1] R. R. Kuczynski, in *Quarterly Journal of Economics*, Vol. XVI, pp. 143, 146, 183. Cp. some equally striking figures given by A. A. Young for New Hampshire in *Publications American Statistical Association*, September, 1905.

These figures are for the crude birth rate (births per 1000 of population) and exaggerate the difference in the fecundity of the two classes; for among the foreign born the proportion of persons in the age of reproduction is greater. But even comparing the births in proportion to women of child-bearing age, the rate of increase among the foreign born is twice that among the native, the figures being: —

BIRTH RATES PER 1000 WOMEN AGED 14–49

	1883–1887	1888–1892	1893–1897
Native mothers	63.7	62.8	62.6
Foreign-born mothers	124.5	133.6	139.4

The careful statistician from whom these figures are quoted concluded (in 1901) that the native-born population of Massachusetts was not maintaining itself; if the birth rate which prevailed during 1883–1897 were to continue indefinitely, this population would become extinct. Doubtless it will not continue indefinitely; a readjustment to conditions of stable numbers, probably of numbers increasing somewhat, will come; but a low birth rate will almost surely maintain itself permanently.

In the native-born farming population of the central region of the country, the same relaxation of the rate of growth is showing itself, though not so strikingly as in New England. There, too, the average number of children per marriage tends to decline, because parents are solicitous not only to maintain, but to raise, the social and economic position of their children.

This movement is steadily extending, and is gradually affecting not only those who are usually thought of as being in a more special sense "native born," but the descendants of the immigrants as well. The influence of free institutions and of free opportunities is to lessen, possibly to destroy, the caste-like character of social classes. They lift the second generation of those who immigrate into the United States out of the

lowest of the non-competing groups. In that second generation the birth rate, which had been high among the first arrivals, begins to fall. In the United States the rate of pay for common laborers and unskilled factory workers is kept low, not by a continuing high birth rate within the country, but by a high birth rate and low standard of living in the foreign sources of supply. It is in European countries that the millions are born who steadily replenish the lowest stratum. Once they are settled here, the leaven of social and economic ambition slowly but surely affects them. It makes well-nigh certain a relaxation of the rate of growth in population. As, in the course of time, natural resources come to be more completely preempted and the possibility of increase is subjected to the conditions of an older country, the Malthusian difficulty, there can be little doubt, will be staved off by the increasing application of the preventive check.

§ 3. The question which now faces the advanced countries, and especially the more prosperous classes in those countries, is whether the preventive check is not likely to be carried too far. The population of France as a whole barely maintains itself; it is probable that the French well-to-do fail to maintain themselves at all. The native-born population of Massachusetts probably fails to maintain itself; it is well-nigh certain that this is the case among the well-to-do in that state. The causes of the phenomenon are an excess of social ambition,— forethought to the point of timidity. People's notions as to what is a proper mode of living steadily become more exacting, and the expense of maintaining a family on the conventional scale becomes greater. Marriages take place at a comparatively late age, and the proportion of those who do not marry at all is considerable. Where there is accumulated property, large families are avoided lest the inheritance be split up among too many. The very rich seem to multiply least rapidly of all.

This tendency brings evils. It takes away part of the stimulus which comes from competition and pressure. Children who are too carefully reared, too elaborately educated, too

fully assured of support from inherited means, lack courage. It would seem, also, that the children of parents who have led a nervously exhausting life, especially if the parents have married late, lack vigor. A population which marries earlier and multiplies more rapidly, and whose newly accruing members are thrown more upon their own resources, is likely to be more progressive.

Further, the more prosperous strata among the population are those in which intellectual gifts are most likely to appear. They are prosperous in the main because they have such gifts. No doubt there are plenty of commonplace persons in the favored classes among whom multiplication is so markedly restricted. But the able and the intelligent are also preponderantly among them. Hence in this tendency among the well-to-do there is a danger that the quality of the population will deteriorate. Less of the gifted are born. and those who are born are less stimulated by active competition to exercise their gifts to the utmost. The lower strata of the population, on the other hand, multiply most rapidly. Though some individuals of high qualities emerge from among them, the great mass are mediocre, and perpetuate mediocrity. Those few whose unusual abilities enable them to rise, succumb to the social ambitions and inhibitions which prevail in the prosperous class, and, like their new associates, fail to propagate freely.

More and more thought has been given of late years to the strange contrast between our care in breeding animals and our carelessness in breeding men. The human race could be immensely improved in quality, and its capacity for happy living immensely increased, if those of poor physical and mental endowment were prevented from multiplying. But it is very uncertain how far it will prove possible to select for propagation. Though the great broad fact of heredity is unmistakeable, the details of the laws of inheritance are but dimly known to us, above all in their application to man. More light will come in time from what is called eugenics; that is, from systematic inquiry as to the transmittal of inborn and acquired traits

from generation to generation, with a view to the possibilities of selection and breeding. In the present state of knowledge, no individual differentiation is feasible; least of all do we know what are the conditions which lead to the birth of individuals having extraordinary gifts. And even if more accurate knowledge comes to be attained, any system of restriction and selection would probably be inconsistent with that striving for freedom of opportunity and for individual development which is the essence of the aspiration for progress. It is difficult to conceive any such system which would not imply the sacrifice of present happiness by countless individuals, for the sake of a cold and distant ideal of ultimate racial improvement. Only some very limited applications of the principle, in extreme cases, seem now within the bounds of possibility. Certain types of criminals and paupers breed only their kind, and society has a right and a duty to protect its members from the repeated burden of maintaining and guarding such parasites. Some sorts of disease and taint are inherited, and it is merciful alike to would-be parents and possible offspring to put a check on their transmission. Beyond this, there is little prospect, under any social system which we can conceive, that mankind will deliberately select a portion among its members as alone privileged to perpetuate the race.

Too much stress should not be laid on what is called "race suicide." The extent of the drift toward restraint among the well-to-do is often exaggerated. Though prudence might possibly be carried to the point of impending annihilation among the higher strata, it will probably not be. Rapid multiplication and large families in these classes are indeed not likely. But a maintenance of their numbers and a moderate increase are by no means improbable. Something will depend on the ideals which influence their lives. Frivolous ambition, the love of vulgar display, the exaggeration of artificial distinctions, all tend to hesitation in marriage and timorousness in begetting offspring. Higher ideals and ambitions tend to the earlier founding of families and to less limited fecundity.

On the other hand, the good sides of restraint on multiplication should not be forgotten. For mankind as a whole, declining birth rates and lessening pressure on population mean progress, not deterioration. The prevalence of habits of prudence among all strata means a gain in human happiness. Possibly the time will come when this sort of prudence will be carried so far that population in the advanced communities will no longer increase at all. Then a low birth rate will be balanced by a low death rate, avoidable suffering and disease will be reduced to the minimum, the average duration of life will be longer. Progress, then, will perhaps be less; or at least it will be in a different direction, with different consequences, and under different impulses. There is no reason why the arts of production should not continue to advance, and certainly no reason why the intellectual and moral life should not move upward. The struggle and competition of rapidly increasing numbers are not essential for happiness, nor is an approach to stationary population in itself a cause of unhappiness. In such a state — to quote the eloquent words of the most wide-minded of the earlier economists, John Stuart Mill — "there would be as much scope as ever for all kinds of mental culture, and moral and social progress; as much room for improving the Art of Living, and much more likelihood of its being improved, when minds ceased to be engrossed by the art of getting on. . . . Only when, in addition to just institutions, the increase of mankind shall be under the deliberate guidance of judicious foresight, can the conquests made from the powers of nature by the intellect and energy of scientific discoveries, be made the common property of the species, and the means of improving and elevating the universal lot." [1]

[1] *Political Economy*, Book IV, Chapter VI, § 2.

CHAPTER 54

INEQUALITY AND ITS CAUSES

§ 1. The overshadowing fact in the distribution of property and income is inequality. How great is the inequality, and what are its causes?

In view of the enormous interest of this topic, the meagerness of our information is surprising. Statistics based on income tax returns supply data that may be considered accurate; but they exist for a few countries only. For some others we have figures which, though statistically less rigorous, still give significant indications as to the proportions of the rich, the well-to-do, the poor. But for most countries, including the United States, we have no precise information whatever. Nevertheless, familiar observation, supported and supplemented by such figures as we have, suffices not only to assure us of the fact of inequality, but to show its general range and character. We know that the number of the rich is very small; that the number of persons who are well-to-do and comfortable, though considerably larger, is still small; and that the persons with slender incomes are the most numerous of all. With only one exception of importance, to be noted presently, distribution, both of wealth and income, has a form roughly pyramidal. To put the analogy more carefully, its form is like that of an inverted peg top, — the lowest range small, then a very large extension, and thereafter steady shrinkage as the highest point is approached.

It will suffice to give a few typical figures. The best tax statistics, of a kind to show the distribution of income among the individuals of a large country, are those of Prussia.[1] The

[1] Compare what is said below, in Book VIII, Chapter 67, of income tax methods.

following figures are for the year 1908; almost any other recent year would show the same results.

Out of a total Prussian population of 38,000,000, no less than 18,000,000 (8,330,000 taxable persons) were not affected by the income tax, because the income of the several taxable persons was supposed to be less than the exempt amount, — 900 marks.[1] There were taxable and assessed, because having an income exceeding the exempt amount, 5,872,000 persons. Among these, incomes were distributed as follows (in round numbers): —

Taxable Persons						
5,284,000,	or 90	per cent,	had	incomes	of	900 @ 3,000 marks
411,000	" 7	"	"	"	"	3,000 @ 6,500 "
76,600	" 1.3	"	"	"	"	6,500 @ 9,500 "
83,200	" 1.4	"	"	"	"	9,500 @ 30,500 "
18,000	" .25	"	"	"	"	30,500 @ 100,000 "
3,800	" .05	"	"	"	"	over 100,000 "

If the line between those who are well-to-do and those who are not be drawn at 3000 marks, it appears that roughly no more than ten per cent of the taxed persons belonged to the well-to-do classes.

These figures take account only of the persons coming within the range of the income tax. There is guesswork concerning those below the exempt amount. Assessment of persons whose income is near the limit is believed to be very inexact; it is supposed that one half of the persons who are not assessed have yet an income as large as 900 marks. For the whole population of Prussia, whether reached by income tax or not, the following estimate (for the year 1899) has been made by high authority: —

4,500,000 families have incomes of 900 marks or less, an average of say 650 marks.

2,500,000 families have incomes of 900 @ 3000 marks, an average of say 1350 marks.

400,000 families have incomes of 3000 @ 100,000 marks, an average of say 10,000 marks.

[1] A few among these were relieved from the tax, though possessing over 900 marks income, for special reasons.

Of the whole number of families, a trifle over five per cent are well-to-do, having incomes over 3000 marks; the distribution among these being sharply pyramidal, as was indicated in the first set of figures.[1]

The British income tax is not so framed as to give direct information regarding the incomes of the individual taxpayers;[2] but it gives materials from which an estimate can be made, sufficiently accurate for the present purpose, of the distribution of incomes in Great Britain. The following figures are reached (for 1904):—

The number of families having incomes	under	£160		was	6,775,000
The number of incomes between		£160 and	£700	"	830,000
" " " " "		£700 "	£2,000	"	122,000
" " " " "		£2,000 "	£5,000	"	32,400
" " " " "		£5,000 "	£50,000	"	14,200
" " " "	over	£50,000	. . . .		350

The result may be stated in another way: in a population of 43,000,000, about 5,000,000 belong to families having an income of £160 a year or more, and these 5,000,000 have about one half of the total income of the British people; the remaining 38,000,000, with incomes of less than £160 per family, have the other half of the total income. These figures cannot pretend to rigorous accuracy. Persons who are disposed to defend and justify existing inequalities usually reach estimates showing a smaller number of very great incomes and a larger number of middle-class incomes. The details of these calculations are of interest and importance for statisticians, but are of little consequence for the purposes of a broad survey. The figures here cited give a sufficiently truthful picture of the inequality in the distribution of income in advanced countries.[3]

[1] These are Professor Schmoller's estimates (for the year 1899), in his *Grundriss der Volkswirthschaftslehre*, Vol. II, pp. 139–140.

[2] See below, Book VIII, Chapter 67, § 3.

[3] The figures are derived from those submitted (but not vouched for as statistically accurate) by Mr. A. L. Bowley; to be found in the *Report of the Committee on Income Tax*, Parl. Doc. 1906, Vol. IX, p. 229. My grouping of the figures of incomes above £160 is somewhat different from Mr. Bowley's, and I have added Mr.

An entirely different basis for gauging distribution was used by Mr. Charles Booth. In his monumental researches on London, not being able to secure direct information as to incomes, he resorted to the test — obviously a significant one — of servant keeping. There is the broad line of demarcation between the class without servants and that with them; and, in the latter class, subdivision according to the number of servants. It appeared that four fifths of the population of London (80.1 per cent), or 3,372,000 persons in all, belonged to the non-servant-keeping class. The upper or servant-keeping class numbered 476,000 persons, or 11 per cent of the population (the remaining 9 per cent of the population included the servants themselves, and inmates of hotels, lodging houses, and institutions, and others not readily brought within the scheme

	Number of Persons	Per Cent of the Population	
Servant-keeping class, total	476,250	11.0	
Subdivided thus:			
a. Servants kept, 1	228,000	5.5	11%
b. " " 2	144,000	3.4	
c. " " 3	57,700	1.3	
d. " " 4	18,800	0.4	
e. " " 5	13,300	0.3	
f. " " 6	7,100	0.2	
g. " " 7	3,000	0.1	
h. " " more than 7	4,350	0.1	
Class keeping no servants	3,372,000	80.1	

Chiozza Money's estimate of the total of families having an income less than £160. The dividing line is put at this point (£160) because of the exemption of incomes below it. See also Mr. Chiozza Money's *Riches and Poverty* (1906), p. 41, and *passim;* the Parliamentary Report just cited, in which there is a mass of information; Mr. W. H. Mallock's *The Nation as a Business Firm* (1910), in which it is attempted, with some success, to show that distribution is not quite so uneven as previous inquirers had concluded; and Professor A. A. Young's review of Mr. Mallock's book in the *Quarterly Journal of Economics* for February, 1911.

Valuable summaries of the statistical information for all countries have been contributed by Dr. Robert Meyer to the successive edition of the *Handwörterbuch der Staatswissenschaften, sub verb.* "Einkommen."

of classification). The upper class proved to be divisible into sections, according to the number of servants per household (see table on preceding page).[1]

On the basis of direct observation, Mr. Booth classified the population of London as follows: —

	Number of Persons	Per Cent of Population
Class *A* (lowest)	38,000	0.9
" *B* (very poor)	317,000	7.5
" *C* and *D* (poor)	938,000	22.3
" *E* and *F* (comfortable, working)	2,166,000	51.5
" *G* (lower middle)	500,000	11.9
" *H* (highest)	250,000	5.9

These figures serve to indicate the exception, intimated a few moments ago, to the statement that distribution has a completely pyramidal shape. It is pyramidal only until the very lowest tier is reached. In that tier, numbers are not larger than in the tier preceding. Not the very poor, but the comparatively comfortable working class, constitute the largest single element in the population of London. Such would seem also to be the case in Prussia, if we admit that the income tax statistics are at fault in ascribing an income of less than 900 marks to a great number who, in fact, have an income as large. Probably the same result, as regards the lowest class, would be reached if we had trustworthy information or indications as to the distribution of incomes in any of the advanced countries, such as Great Britain, France, the United States.

§ 2. The situation as regards the distribution of ownership of property is essentially the same. One or two sets of figures will suffice for illustration. The British inheritance taxes have

[1] *Life and Labour of the People of London*, Second Series, Vol. I, p. 5 *seq.* (edition of 1903). For brevity I have described section *a* as keeping one servant, section *b* as keeping two servants, and so on. In Mr. Booth's careful analysis, section *b* includes some small families with but one servant, as well as large families with two servants; section *c* some small families with but two servants, as well as larger families with three servants; and so on.

been carefully administered on the same basis for many years; not throughout with the same rates of taxation, but in a manner to show for a long period what are the numbers of estates of varying sizes. Taking the ten years from the fiscal year 1899–1900 through the fiscal year 1908–1909, we find that, on the average, there were probated each year estates as follows:[1] —

Small estates, not exceeding		£500	48,000
Estates from	£500 to	£1,000	9,933
" "	1,000 "	10,000	16,484
" "	10,000 "	25,000	2,311
" "	25,000 "	50,000	911
" "	50,000 "	75,000	286
" "	75,000 "	100,000	140
" "	100,000 "	150,000	135
" "	150,000 "	250,000	88
" "	250,000 "	500,000	51
" "	500,000 "	1,000,000	18
" over 1,000,000			7 to 8

For Prussia we have figures of a similar sort, published in connection with the *Ergänzungssteuer*, a tax based on the income tax returns, but levied with respect to property, not income. In 1908, there were in round numbers 1,500,000 persons assessed as having property of 6000 marks or more; these persons and their families numbered 5,350,000 in all. Among the persons assessed:[2] —

731,700	persons had property from	6,000 to	20,000 marks
262,300	" " " "	20,000 "	32,000 "
203,800	" " " "	32,000 "	52,000 "
160,500	" " " "	52,000 "	100,000 "
79,900	" " " "	100,000 "	200,000 "
43,360	" " " "	200,000 "	500,000 "
12,600	" " " "	500,000 "	1,000,000 "
5,300	" " " "	1,000,000 "	2,000,000 "
3,000	" " "	over 2,000,000 marks.	

[1] I have calculated these averages, for all except the smallest estates, from the figures given for the several years in the *Statistical Abstract for the United Kingdom*. For the smallest estates, the *Statistical Abstract* does not give the full total, since it takes no account of estates less than £100 net. The figure given above (the first in the table) is in round numbers, and is not statistically accurate; but it is accurate enough for the purpose in hand.

[2] I take these figures from the *Vergleichende Uebersicht* submitted to the Prussion Landtag for the fiscal year 1908–1909. They give the assessments made for the triennial period 1908–1910.

The results are for both countries essentially similar to those for incomes. The number of millionaires is very small indeed; that of the rich remains still small; the numbers become larger as the properties become less; the very least properties are the most numerous of all. Just how far down in the scale the same tendency would extend, it is impossible to say; but it is certain that the persons having properties below the limits in these tables greatly exceed in number those within their range. In Great Britain, only one out of six adults leaves at death as much as £100 of property, and only one out of twenty leaves as much as £1000.[1] In Prussia about one out of seven in the population had 6000 marks or more; six sevenths were not affected by the property tax, because their property was less than 6000 marks.[2] Those who possess any considerable amount are but a small minority of the population in any of the countries of advanced civilization.

To the general statement that distribution tends to be tapering, one qualification should be attached. In most countries the ownership of agricultural land is not highly concentrated. It is highly concentrated in Great Britain; and hence in her case the general situation is specially accentuated. But in southern and western Germany, in France, in the Scandinavian countries, peasant proprietorship is the rule, and a great host of persons hence are property owners on a moderate scale. This is doubtless the main reason why the proportion of property owners, as indicated by the figures just given, is larger in Prussia than in Great Britain. So, in the United States, the independent farmer, owning and tilling the "one-family farm," is still the typical figure in agriculture. As farming has not succumbed to the drift toward large-scale production, so it does

[1] Mr. Chiozza Money, in his *Riches and Poverty*, pp. 51, 72, overstates the case, remarking that only one out of ten in the population leaves any property at death. As Mr. A. L. Bowley has pointed out to me, the significant proportion is not to total population, but to the adult population; hence the proportion stated in the text, — one out of six adults.

[2] The total population of Prussia in 1908 was 38,000,000; the families of the 1,500,000 persons assessed for property tax numbered 5,350,000 heads.

not manifest the tendency to concentration of wealth which is in general the consequence of large-scale production. Barring this exception, we may say that inequality, and a pyramidal form of inequality, is characteristic of the distribution of property as well as of income.

§ 3. Another question is whether inequality is becoming greater or less; whether it is true, as often alleged, that the rich are becoming richer, and the poor poorer. Here, again, almost the only sources of precise information are in the income tax statistics of German states. These indicate that in Germany the rich are indeed becoming richer, but the poor not poorer. The incomes of the poor are rising. There is, further, a steady movement upwards; a certain proportion of persons are constantly swinging themselves into a more prosperous tier. The comfortable working class and the lower middle class become not weaker, but stronger. But the incomes of the rich are rising also, and the proportion of persons in the well-to-do and rich classes is becoming greater. The class of the rich, though it remains small, seems to grow faster in numbers than the other classes, and the proportion swells which the rich secure of the total income. Yet there is no tendency toward the disappearance of the middle class; nor is there any tendency toward the complete absorption of the high incomes by a decreasing number of very rich persons. There are thus indications of an increasing concentration of income (and presumably of wealth) in the hands of the most prosperous classes, yet with an increase in the numbers of that class, and not at the expense of any deterioration in the condition of the less prosperous. These are not, in the view of persons to whom marked inequality is in itself unwelcome, tendencies toward an ideal situation. But they are probably the inevitable accompaniments of a rapid burst of progress.

In the United States the accumulation of conspicuous great fortunes has led to a belief in many quarters that inequality is rapidly becoming much more accentuated. But the country is vast and its population enormous; the persons of the middle

class, whether in its lower or upper range, though not so conspicuous as the rich, are very many. It is possible that the numbers and the incomes of the millionaires have increased relatively to the numbers and incomes of those who are simply rich or well-to-do; for the topmost class has been swelled not only by the working of the modern tendency to large-scale industry, but also by the peculiar conditions of American corporations, by the wider range of privately managed industries, by the extraordinary pace of material progress. We are quite without accurate information as to the distribution of income in our own country, and as to the drift of changes in distribution. It may be guessed that on the whole the situation is not essentially different from that in a country like Prussia, but with everything on a larger scale.[1]

§ 4. Such are the broad facts as to inequality. How are they to be explained? and how, if at all, to be justified?

The causes of inequality are reducible to two, — inborn differences in gifts, and the maintenance of acquired advantages through environment and through the inheritance of property. The origin of inequality is to be found in the unequal endowments of men; its perpetuation in the influence of the inheritance both of property and of opportunity, and also in the continued influence of native ability transmitted from ancestor to descendant.

No doubt at the outset all differences arose from the inborn superiority of some men over others. The savage chief excels his fellows in strength and in cunning. Throughout history

[1] On the tendencies in distribution shown by German figures, see the well-known paper by Professor Adolf Wagner in the *Zeitschrift d. Preuss. Statist. Bureau*, 1904, p. 92 and *passim*. His conclusions are confirmed by Robert Meyer, in the *Handwörterbuch der Staatswissenschaften*, Vol. III, p. 688 (third edition, 1909). Cp. Sombart, *Deutsche Volkswirtschaft im 19. Jahrhundert*, p. 506. Guesses for the United States are in C. B. Spahr's *Present Distribution of Wealth in the United States* (1896).

The well-known proposal of Professor Pareto to state the general tendency in mathematical terms is in his *Cours d'Économie Politique*, Vol. II, Book III, Chapter I, where are also figures from various sources. Professor Pareto points out that distribution has not so much the shape of a pyramid as the more rounded and tapering shape of an inverted peg top.

the strong and able have come to the fore. They continue to do so in the peaceful rivalry of civilized communities. In our present society, the differences in wages — that is, in the incomes from all sorts of labor — are the results, in large degree at least, of differences in endowments. The striking case in modern times is that of the business man. Especially in the upper tier, high native ability explains the exceptional earnings of the fortunate few among the business class. In other occupations, though training and environment count for much, inborn gifts are still of dominant importance in explaining the largest incomes from labor.

But at a very early stage in the development of society, this original cause of difference is modified, often thrust aside, by the perpetuation of established advantages. In the feudal system, and in any society organized on a basis of caste, inequality is maintained by force of rigid law. In the supposedly free and competitive society of modern times, advantage still tends to maintain itself. It does so in two ways, — through the influence of environment and opportunity, and through the inheritance of property.

Environment and opportunity have already been considered.[1] Though it is not certain to what degree social stratification rests on factitious advantages, to what degree on the inborn moral and intellectual qualities of the several classes, it is clear that the artificial causes play a great part. A multitude of forces tend to keep a person in the social grade of his parents. Only those of exceptional gifts rise easily above it, and only those of exceptional defects fall below it.

More important, however, is the direct inheritance of property. Its influence is enormous. Obviously, this alone explains the perpetuation of "funded" incomes, — those derived from capital, land, income-yielding property of all sorts, — and so explains the great continuing gulf between the haves and the have-nots. It serves also to strengthen all the lines of social stratification, and to reënforce the influences of custom and

[1] Chapter 47.

habit. Persons who inherit property inherit also opportunity. They have a better start, a more stimulating environment, a higher ambition. They are likely to secure higher incomes, and to preserve a higher standard of living by late marriages and few offspring. The institution of inheritance promotes social stratification through its indirect effects not less than through its direct.

Nothing illustrates so fully the combined influence of inborn gifts, of property inheritance, of perpetuated environment, as the position of the person dominant in modern society, — the money-making business man. In the first stages of any individual business man's career, the possession of means counts for much. After the initial stage, native ability tells more and more. By whatever ways he gets his start, the leader of industry prospers and accumulates; and, as he accumulates, is again favored more and more by large possessions. When he dies, he leaves a trail of descendants, who perhaps inherit ability and almost certainly inherit property. With property they inherit a new environment and new opportunities. It may indeed happen that the property will be dissipated through lack of thrift or judgment, or subdivided among heirs into minute portions. But neither of these results is probable; and even if they occur, the descendants have ambitions and surroundings very different from those of the poorer class from which the ancestor may have sprung. In every way inequalities, even though they arise at the outset without favor, tend to be perpetuated by inheritance and environment.

§ 5. What can be said in justification of the inheritance of property, which acts so powerfully to maintain inequality?

Inheritance arose historically from the sense of the unity of the family. The ancestor in early times was not so much the immediate owner of the property as the head and representative of the family which owned the property. Its devolution to the surviving members was no change of ownership, but a transfer to new representatives of the continuing owners. But this explanation of inheritance, though historically

sufficient, serves little to explain the institution as it stands now, still less to justify it. The ground on which inheritance is now to be defended is frankly utilitarian. In a society organized on the basis of private property, inheritance is essential to the maintenance of capital.

It may be open to question how far inheritance is necessary for the first steps in accumulation. The motives that lead to money-making and to the initial stages of saving and investment are various: not only the safeguarding of the future for one's self and one's dependents, but social ambition, the love of distinction, the impulses to activity and to domination. But, for sustained accumulation and permanent investment, the main motives are domestic affection and family ambition. The bequest of a competence or a fortune, though often a dubious boon for the descendants, is a mainspring for its upbuilding by the ancestor. If we were to put an end to inheritance, decreeing that all estates should escheat to the public at death, the owner would commonly dissipate his property. One of the motives for its first acquisition would be gone, and certainly the chief motive for its maintenance. Why accumulate and invest for the benefit of the community at large?

It is on this ground that the taxation of inheritance should be kept within limits. As will appear later, the transfer of property at death gives a convenient occasion for the levy of taxes and for the application of progressive rates.[1] But such taxes tend to trench on capital. Unless kept within moderate limits, they are paid out of the principal of the estate, not out of income; and this lessening of individual's "capital" presumably leads to a corresponding lessening of social capital. More than this: the higher they become, and the nearer they approach to confiscation, the more probable it is that the original accumulation of capital will be checked. Just at what point a harmful effect is reached — at what point the social gain from the tax revenue and from the mitigation of inequality

[1] See Book VIII, Chapter 67, § 5, and in general what is said in Chapters 66 and 67 on Progressive Taxation.

is outweighed by the social loss from the curtailment of capital — is as impossible to say as it is to determine just at what rate interest must remain in order to induce accumulation. A limit, none the less, there is. The fact that taxes on inheritances and on the recipients of funded incomes can be levied at moderate rates without leading to sensible impairment of capital does not prove that they can be raised indefinitely higher without this consequence.

As moderate taxes on inheritances are not inconsistent with the maintenance of the essential utility of the institution, so some limitations on bequest and inheritance are not inconsistent. There is no reason why intestate succession should proceed indefinitely to the most distant kin. Where a man does not trouble himself to make a will, it may fairly be presumed that his property was not got together with an eye to distant heirs. Neither his accumulation nor that by others will be checked if the public appropriates a great slice, even the whole, of such windfalls. On similar grounds it is justifiable to make succession taxes heavier as the degree of relationship to the decedent — whether testate or intestate — becomes more and more remote.

Something of the same sort may be said in favor of the limitation, suggested long ago by John Stuart Mill, of the sum transmissible to any single heir or devisee. So long as the possessor of property is free to dispose of it (or the bulk of it, after the deduction of inheritance taxes) according to his own volition, he may be expected to refrain from dissipating it during his lifetime. The ground here is indeed more uncertain. Though the money-gathering impulses, strong in themselves, are in such a case strengthened by the liberty to dispose of the property in some way, the limitation of the amounts transmissible to immediate descendants may operate to check accumulation. Here we must fall back on the probability that what may conceivably be lost to capital in this way will be made up by the growth of accumulation elsewhere; for in our modern societies the forces that lead to accumulation are

enormously powerful, and are likely to override all but the strongest obstacles. The French system, of limiting the amount which may go outside the circle of heirs (only so much can be freely devised as equals the share of any one heir), seems of much more disputable advantage. It assures to each heir a property, perhaps a large one, irrespective of his desert in the eyes of the decedent or of the world at large; it limits the power of bequest for public purposes; and it cannot be supposed to foster accumulation more than would complete freedom of bequest.

Inheritance, in sum, is an indispensable part of the institution of property. So long as the community relies on accumulation by individuals, and on ownership and management by them, for the supply of its material equipment, it must give scope to the motives that lead to the formation and maintenance of capital through the action of these individuals.

§ 6. What now of the ulterior question, — the basis of the whole régime of private property? Something may be said on this topic here, even though the consideration of the closely related topic of socialism is postponed to a later stage.[1]

The theory that property rests on labor, and therefore on what is conceived to be the "natural" right of each man to that which he has produced, has gone into the lumber room of discarded doctrines. It was elaborated by Locke, accepted more or less through the eighteenth century, and used freely by the English economists of the first half of the nineteenth century. But it plays little part in modern discussion. "Natural" rights have quite gone out of fashion. Where there is a highly complex division of labor, such as characterizes existing society, it is impossible to distinguish how much any one individual has contributed to the whole output, — to say, this is his specific output, therefore rightly his property. Even if it were possible so to distinguish, no natural or inherent right would thereby be established. Least of all is it possible on such reasoning to justify inheritance. As the institution of inheritance can be

[1] See Book VII, Chapters 64 and 65.

sustained only on a basis of utilitarianism, so can that of property in general.

The utilitarian reasoning may be summarized as follows: —

Men will not labor steadily and effectively except in their own behalf. Labor is irksome, the sense of common interest weak. Labor will not be exerted continuously and vigorously except for individual benefit. It is strenuous and well directed in proportion to the expected return.

Inequality arises even under the simplest conditions, from the unequal endowments of men. It becomes accentuated with the growing complexity of the division of labor. Where there is no division of labor, every man is led to do that which brings to him for his own uses the largest direct return to labor. In a varied society, he is led to do that which brings indirectly the largest return; that which others value highly and for which they will pay highly. Competition and self-interest thus promote not only the vigor of labor, but the effective organization of production. Above all, as the industrial situation becomes complex, the middleman appears — the employer, merchant, banker; indispensable figures for the progress of industry. Inequality becomes more marked as increasing complexity gives play to very varying abilities. Whether due to differences of inborn gifts or to the developing differences that arise from acquired advantage, it remains an indispensable spur to the full exercise of each man's capacities.

Wide variations thus arise, in earnings, possessions, available surplus. The essence of capital is surplus.[1] Accumulation takes place by many individuals, and surplus means are utilized by those who see time-using ways of directing labor with effect. Sustained accumulation and investment on a large scale will not take place unless there be an inducement. The phenomenon of interest on capital appears. Not less than interest, inheritance, whatever its historic origin, operates as an indispensable stimulus to the saving of private means and the increase of social capital.

[1] Compare Book I, Chapter 5, § 3.

So the leisure class emerges, — the result of inequality, accumulation, interest, inheritance. The immediate effect of idleness on the part of a fraction of the community is obviously to lessen the total available labor force; the great mass must work not only for their own maintenance, but for that of this privileged fraction. But the prospect of being a member of the leisure class has proved a wonderfully powerful bait to effective exertion and permanent investment. False as the ideal of exemption from labor seems to the thinking few, and doubtful as may be the happiness of those born to a life of leisure, the hope of privileged position for one's self or one's kin has been the main motive force for the material progress of society.

Property in land is part of the mechanism for stimulating effective labor and effective investment. Production cannot be carried on without land; all plant must be incorporated in a site. Full title and ownership to land have been indispensable to the growth of capital. Whether or no such unqualified property right be essential in an ideally constructed society, and whatever be the possibilities of future restriction in modern communities, absolute private title to land has been historically the means of securing its effective use. Thus rent develops as an element in distribution, in part intermingled with return on capital beyond possibility of discrimination, and in any case an inevitable outgrowth of the system of property in its cruder stages.

The reasoning of the preceding paragraphs, followed without flinching and without qualification, would lead to the conclusion that desert on the part of members of the leisure class is not necessary to justify the existence of the class. Its position of ease and comfort is a bait to stimulate ambition and accumulation. Direct service by the survivors and descendants of fortune founders would seem to be immaterial. Yet the current notions of justice, vague though they are, connote some closer relation between service and reward; and the question persists whether the personal qualities of the privileged and their im-

mediate contribution to the common welfare must not be considered in any solid justification of existing inequality.

The question is answered in the affirmative by many thinkers,[1] who hold that there must be a continuing service from the class as a whole, if not from each and every member. It is pointed out that, though the origin of inequality is to be traced to the unequal endowments of men, it is to be sought also in varying services. In the earlier stages of developing stratification, social classes — whether priestly or feudal or industrial — sprang up because some individuals were in a greater measure serviceable to the general body. Not merely predatory strength and cunning, but abilities exercised in a manner to advance the common good, explain the universal differentiation of society. But during the later stages, when the superior classes have attained an established position of privilege, it becomes doubtful whether ability and service are maintained and whether the justification of inequality still holds.

Such questions go to the foundations of the theory of ethics. On strict hedonistic principles, it may be consistently maintained that personal desert is immaterial. The coolly calculating economist may accept the idle rich as inevitable adjuncts of a system which is itself founded on the intellectual and moral limitations of men, and he may leave their way of life to the preacher. I will not undertake to say what are the last criteria of justice, for individuals or for society; but it is obvious that the justification of inequality and of all its consequences becomes more effective when the leisure class is of service directly as well as indirectly. Though the mere existence of a capitalistic aristocracy operates to spur ambition and to conserve capital, its position is immensely stronger if the individual members contribute actively to the general well-being, through continued industrial leadership, through the advancement of science, literature, and art, through high-minded public service.

[1] See, for example, Schmoller, *Volkswirthschaftslehre*, Vol. I, pp. 409–411. Cp. Paulsen, *Ethik*, Book IV, Part III, Chapter III, § 3 (p. 713, ed. of 1889); and Dewey and Tufts, *Ethics*, Chapter XXIII, §§ 1–3.

Whether contributions of this sort will, in fact, be rendered, depends not only on ability (and this again on heredity), but on the public opinion of the privileged class and indeed of society at large. It cannot be said that the habits and ideals of the rich give great promise.

> Rapine, avarice, expense,
> This is idolatry; and these we adore.

Nor are the ideals of the great mass of the people essentially different. They are not genuinely censorious of the rich, but rather envious, and ready to imitate their ways. How far the spread of better education and the democratization of society will affect the prevailing ideals, it would be rash to predict. Something is gained if the situation is laid bare; and herein the growing attention to economic and social subjects promotes improvement. A widespread understanding of economic principles, of the broad facts of social stratification, of the singular position of the privileged few, of the public loss from useless lives, of the fallaciousness and emptiness of the talk now common on social subjects among the well-to-do, — such knowledge may do something to spur the fortunate to lead lives of service. Certain it is that the opinions of most persons, and especially of those imbued with some sense of social obligation, will be affected by the immediate and visible contributions which the members of the leisure class may make to the general good.

§ 7. Such is the analysis of the foundations on which the institution of property rests. It applies to the sound core of the system, by no means to all the excrescences. The history of modern capitalism tells a mixed story, — not only of vigor and competition and progress, but of monopoly, exploitation, unearned incomes and unearned increments. The justificatory account just given would be a fairly accurate description of what has actually taken place in very few communities, if in any; such, possibly, was New England to the middle of the nineteenth century. The wrongs of the past, perpetuated by the institution of inheritance, weigh heavily on almost all of

the modern world. The maintenance of things as they stand is dependent in very great degree on the principle of vested interests,—the repeated sales and transfers of properties and rights, and the impossibility of probing far into the past. As with land and urban sites,[1] so it is with almost all property. The community has maintained for centuries the unqualified right of property; it has encouraged men to buy and sell on that basis, to invest and to shift investments, to commit themselves irrevocably. It cannot uproot the past.

The future can be prepared for in better ways. The institution of property can be refined, and the discordances of the past can be prevented from recurring. The chapters that follow will consider the possible ways of limiting and regulating the régime of property. In various directions the working of capitalism needs to be modified; and the problems thus arising are by far the most important that confront society.

None the less, for a long time to come, as far in the future as we can foresee with any approach to certainty, the essentials of private property will remain; and therewith inequality. The trend of the time is leveling. Property, privilege, the leisure class, are on the defensive. Mitigation of existing discrepancies and of extreme differences underlies the regulative and constructive legislation of our day. But there is no prospect that we shall be able to dispense with individual interest, individual ownership, individual accumulation. All these are indispensable for vigor of production and for progress; and they spell inequality. The main features of the existing distribution of wealth are likely to persist for an indefinite period in the future; shorn, indeed, at either end, of the extremes of abject poverty and endless riches, but still with rich and poor, leisure class and well-to-do class and working class, social stratification and the leaven of social ambition. A tapering social structure will long persist.

[1] Compare Book V, Chapter 44, § 4.

References on Book V

On the theory of distribution in general, as on that of value, the first book to be mentioned is A. Marshall, *Principles of Economics*, Books IV, V, VI (6th ed., 1910). A compact and able theoretic analysis is in T. N. Carver, *The Distribution of Wealth* (1904). Entirely different in method, with a wealth of historical and statistical analysis, and large-minded treatment of the underlying social problems, is G. Schmoller, *Grundriss der Volkswirtschaftslehre*, Books III, IV (1900–1904; French translation, 1905–1908).

Among the many modern books on capital and interest, Böhm-Bawerk, *Positive Theory of Capital* (English translation, 1891), has most profoundly influenced recent economic thought. A revised edition of the German appeared in 1909. Not inferior to this in intellectual incisiveness, but marked, like it, by some excess of refinement and subtlety, are I. Fisher's two volumes, *The Nature of Capital and Income* (1906), and *The Rate of Interest* (1907). J. B. Clark, *The Distribution of Wealth* (1899), sets forth a theory of wages and interest as the specific products of labor and capital; I find myself unable to accept the reasoning, but to some economists it seems conclusive. An able book, attempting to recast the theory of distribution and value, is Fetter, *Principles of Economics* (1904). An able book by a French thinker is A. Landry, *L'intérêt du capital* (1904).

On urban site rent, interesting descriptive matter is in R. M. Hurd, *Principles of City Land Values* (1903).

J. Bonar, *Malthus* (1885), gives an excellent account of Malthus's writings and of the earlier controversy about his doctrines. A. Dumont, *Dépopulation et civilisation* (1890), not a book of the first rank, states the modern French view, laying stress on "social capillarity" as explaining the decline in the birth rate, and enlarging on the desirability of an increasing population. E. Levasseur, *La Population française* (1892), Vol. III, Part I, gives a good summary statement on the increase of population compared with the growth of wealth. G. Mayr, *Statistik und Gesellschaftslehre:* Vol. II, *Bevölkerungsstatistik* (1897), Vol. III, Part I, *Moralstatistik* (1910), gives a model summary of statistical data and a judicial statement on questions of principle. See also a series of articles by K. Oldenberg, Archiv f. Sozialwissenschaft, Vols. XXII and XXIII; cp. L. Brentano, *Die Malthus'che Lehre*, in Abhandl. d. Bayer. Akademie, 1909.

Notwithstanding the enormous mass of literature on social stratification, there is no one book that treats this topic in a manner thoroughly satisfactory. C. Overberg, *La classe sociale* (1905), may be consulted.

BOOK VI

PROBLEMS OF LABOR

CHAPTER 55

TRADE-UNIONS

§ 1. The subjects to be taken up in this Book and in that to follow differ in important respects from those of the preceding Books. They call in less degree for mere description and analysis, in greater degree for a judgment as to the value of existing institutions and for advice as to reform. Hence the conclusions depend, more than with previous matters, on a weighing of pros and cons. Many of the doctrines laid down hitherto have been definite and positive. They are either true or not true. Such, for example, is the case with the principles of exchange, of international trade, of the value of money and the range of prices, of rent and interest and wages. No doubt, questions of policy have also been considered, and necessarily have led to some balancing of conflicting considerations; as, for example, with regard to banking legislation or the circumstances under which protective duties may be advantageous. But such balancing is peculiarly necessary for the social questions which are now to be taken up. With respect to almost all of them, something is to be said on both sides; in favor of one course of action as well as in favor of an opposite course. No law can be laid down on them, and no conclusion proved by irrefragable reasoning or convincing testimony. Almost invariably there will be room for some difference of opinion. Of this there is ample evidence in the wide divergences of conclusions, and in the bitter controversies, on problems where the facts are undisputed.

Again, the conclusions reached on such questions are immensely influenced by the point of view. It makes all the difference whether the problems are approached in a spirit of

sympathy or of indifferentism. A great deal depends on the warmth of one's social feelings. Now, some men are born with a spirit of fervid altruism, some with but the slenderest strain of a moral sense. Between persons of widely differing temperaments there is little common premise for argument. There is no convincing a person whose whole point of view is different from your own. Largely, no doubt, the pervading moral atmosphere tells. Most well-to-do persons, though by no means selfish or indifferent, are affected by their class feeling, and are unconsciously disposed to be antagonistic to measures looking toward equalization of opportunities and possessions. It is true that they are not so critical and antagonistic as they were fifty or a hundred years ago; for the *Zeitgeist* is becoming kinder, more reformatory, more widely sympathetic. None the less, an underlying opposition to schemes for social equalization appears among the possessing classes, and not least among the business men who now give the tone to these classes. On the other hand, the representatives of the less prosperous strata of society are instinctively in an attitude of opposition. Most things in the existing order of property and competition are repugnant to them, regardless of the beneficial effects and the inevitable concomitants of that order. Here, again, is a cause of differences in opinion not to be reconciled.

In this Book labor problems will be dealt with; in the next, problems of public control and the reorganization of industry. Both sets of problems center about the inequalities of wealth and the ways of mitigating them. I shall try to consider these knotty matters as objectively as possible, not unimbued with the spirit of social sympathy, yet constrained to face the limitations imposed by men's rooted habits and traditions, by the defects of governmental machinery, most of all by the weakness and sordidness of human nature.

§ 2. The trade-union movement is modern. It is mainly a consequence of the industrial revolution, — of the factory system and the concentration of industry. The number of persons employed in a single enterprise and under a single em-

ployer has tended to become larger and larger. Hence personal ties between employer and employee have relaxed or disappeared, and bargaining has become more impersonal and cold-blooded. At the same time concerted action by employees has become easier. Combined with this economic tendency has been the growth of democracy and of the aspirations that go with democracy. The trade-union movement is one of the most important signs of social unrest and social progress. The laborers have become increasingly dissatisfied with a condition of dependence. They wish not only for higher wages, but for emancipation from semipatriarchal conditions. They demand that wages shall not be settled once for all on the employer's offer, but by a contract in which their own action shall play an effective part.

We may proceed at once to the most important economic question presented by trade-unions, — their possible effect on wages. On this subject it might have been said fifty years ago that the opinions of economists and of trade-unionists were far apart; for many economists then maintained that unions could have no effect on wages, while the unionists themselves ascribed every actual rise in wages to their own efforts. The labor leaders are still disposed to lay undue stress on the effects of concerted action; but a middle ground would now be taken by most economists.

It is certain, and indeed obvious, that the bargaining power of hired workmen is strengthened by their acting in a body. Where an employer deals with a hundred workmen, he may be said to be hundred fold stronger in his bargaining position than a single workman. The difference to him whether one of his men goes or stays is only the difference between 100 and 99. But to the workman the alternative is between employment and — for the moment, at least — unemployment. True, the workman may turn elsewhere; and it may be contended that, if he offers his labor at the market rates, he will get employment from some one else. Probably he will; but only after an interval, and with more or less uncertainty. The threat of

discharge, and the workman's fear of losing his job, are powerful weapons in the employer's hands. Where, however, all his workmen present a demand at once, and propose to quit work at once, he is in a corresponding position. Then he, too, will have to stop, and for the moment will lose *his* job; and he will soberly consider whether he can find another set of men on the same terms. If he offers the market rate, doubtless he can secure another hundred; but, like the individual laborer, only after an interval, and with more or less uncertainty and temporary loss.

The advantage possessed by the large employer becomes clear when his position is contrasted with that of one hiring but a single person, or very few persons. The typical middle-class householder, with one or two servants, needs each servant as much as the servant needs him or her. If the mistress gives notice, doubtless the cook can find another place at the going rates; but not at once or without inconvenience. If the cook gives notice, doubtless the mistress can find another at the going rates; but not at once, and with no less inconvenience. Hence in a country like the United States, where the number of well-to-do persons who demand domestic service is great and growing, and the number of those willing to give such service is limited,[1] wages are not only high, but are kept at the high market level without organization among the sellers of labor. If the persons wanting such service commonly maintained ten, twenty, a hundred, domestics apiece, the situation would be different. The single servant would then be weak as a bargainer; and though the general rate of wages would doubtless not be affected, the probability that in each case the actual pay would conform to the general rate would be less.

The usual disadvantage of the laborer in bargaining is due not only to the fact that he is immobile,—cannot quickly find the best market for his labor,—but to his lack of reserve funds and to the perishability of his commodity. In all these respects the difference between employer and employee is often

[1] Compare above, Book V, Chapter 46, § 1.

one of degree only; but it is none the less of vital effect on their relative positions. The workman, as well as the capitalist, may have reserve funds on which to fall back while waiting and bargaining. But they are usually much less than those of the employer, and in the case of most unskilled laborers are virtually nonexistent. So with perishability. There is a sense in which the employer also is like the vendor of a perishable commodity. Machinery and tools depreciate while idle, through the mere lapse of time and through obsolescence; stoppage of production, for a "going concern," means some definitive loss. But it is even more true of the laborer that working time lost is irrevocably lost. As to some sorts of exacting mental labor, a period of rest may add in the end to vigor and efficiency; but this possibility is negligible for most physical labor. If a man is out of work for a day or a week, so much of his earning power is gone once for all.

Organization and concerted action among workmen enable them, to no small degree, to lessen their disabilities. Trade-unions can do much to mitigate the immobility of labor, by collecting information as to the demand and by aiding their members in reaching the right places. Public and private agencies act toward the same end; though private agencies, managed for profit, are themselves likely to take advantage of the laborers' weakness. Trade-unions, by accumulating funds, give their members a better chance to hold out in the process of bargaining. Most important of all, concerted action in stopping work makes the employer feel that the workmen are as needful to him as he to them.

Labor organizations are thus effective toward securing "fair wages"; that is, the current or market rates determined under the conditions of competition. They aid in enabling the laborers to get, in each particular case, the wages determined by the full competitive demand for the special sort of service; and they aid in bringing the general rate of wages to the full discounted value of the product of labor in general. Under the régime of private property and competitive industry, this

is doubtless all that unionism can achieve in raising wages. But it is a great deal. The current or fair rate of wages is not determined automatically or with any accurate demarcation. It is always the result of bargaining. There is always a debatable ground, and a chance for manœuvring by both parties.

§ 3. The concrete problems connected with trade-unions relate always not to wages in general, but to the wages of a particular group of workmen, — those in one trade or a group of related trades. Such wages in the specific case depend on the play of demand for the special kind of service rendered. Limit the supply of workmen in a given trade or group, and the chance is bettered for getting higher wages in that set. This is what the trade-union invariably desires to bring about. The most effective organizations are those of the skilled workmen, — the machinists, bricklayers, carpenters, plumbers, and the like. These are in any event more or less in a non-competing group. Their semi-monopolistic position, though threatened by the spread of education and of the machine processes, is still strong, and is sought to be maintained by various devices. The number of apprentices is limited. Admission to the union is restricted by high initiation dues. In some of the rougher trades, brutal violence is threatened against would-be competitors. Trade schools are opposed. The unionists try to maintain themselves in a favored place as compared with the rest of the laborers.

For this they are not, humanly speaking, to be blamed; but they act against the general interest. Capitalists and employers are no less desirous of shutting out competition and securing monopoly profits. Either sort of combination works against the general good. Though trade-unionism, as a movement for uplifting the laboring class at large and bettering the bargaining conditions for all, must command sympathy; in its particular manifestations it is too often undisguisedly selfish, and so causes repulsion even among its warmest friends.

It is true that the instances of monopoly effective through

trade-union exclusion are not many, and are tending to become less. They occur chiefly in those occupations where the handicraft is still dominant. Such is the case, for example, or was until very recently, with the glass blowers. They had a tight union, succeeded in restricting apprentices, limited numbers, and secured for themselves unusually high wages. As machine methods come to prevail and specialized skill counts less than general training and intelligence, it becomes more and more difficult to maintain such monopolies. In this very trade, new inventions are now (1914) introduced which promise to accomplish by machinery what could formerly be done only by the expert glass man blowing through his tube. None the less, the skilled workmen as a class still jealously guard, though with lessened prospects of success, their privileged position as against other workmen.

It is a significant fact that this restrictive attitude has the sympathy and approval of workmen in general. Most workmen are instinctively protectionists. Not only do they fear unemployment through increase of competition, but they generalize from the particular case, and assume that what is advantageous to some laborers must prove advantageous if applied to all. The bracing doctrine that every one should do his utmost in a free field finds as little spontaneous welcome among the employed as among the employers.

Evidently the dangerous side of trade unionism here considered would disappear if there were the *open union;* that is, if all persons competent to do the work were admitted freely to the union. The union then would be an organization not for monopolistic exclusion, but simply for mutual aid and for collective bargaining.

This is the usual situation in the unions of the unskilled or partly skilled. There has been in recent years a great development of labor organization in the lower ranks, both among factory operatives and among the miscellaneous unskilled. Especially in the United States there has been a wide spread of organization according to mere propinquity of occupation; as,

nearness

for example, among the motormen of the street railways, the switchmen on railways, the longshoremen ("dockers" in England), and the freight handlers, the teamsters, the coal heavers. These are occupations needing at most but a few weeks of experience, to which any able-bodied man can turn. Anything like a monopoly in them is hopeless; unless, indeed (as is too often attempted), by a simple policy of violence. Even violence cannot serve long or effectively, for the good sense of the community revolts against it, and before long stamps it out. These are therefore in the long run necessarily open unions, and free from the reproach of selfish exclusiveness. At the same time, they affect just those classes of workmen who are as individuals most helpless. Unionism among them, so long as it is kept free from the taint of physical brutality, brings a great preponderance of gain. No doubt, their leaders are sometimes demagogues, or (worse) traitors ready to accept bribes. During the earlier and formative stages of organization, they overestimate the gains which the union can bring, and may be turbulent. But on the whole they are potent instruments for good. They not only improve the bargaining position of their members, and raise their wages so far as this factor can further the rise; they bring also educational benefits. During the last generation, workmen of these grades in the United States have been largely foreign born, often immigrants but lately arrived. For these the trade-unions have been great schools, and with all their narrowness of outlook have been helpful in the process of uplift and amalgamation.

In the skilled trades, the policy of opening the union is always resisted as long as possible. At the same time, many of them have learned, and most of them will probably learn, that it is the only safe policy. Exclusion and limitation, as means of forcing wages in particular trades to an abnormal level, bring sooner or later their own breakdown. Employers are put to their wits' ends to find and train outsiders, or to develop improvements which will make it possible to dispense with the skilled men. The spread of education, and especially

of manual training, combined with the steady extension of machine processes, make the position of the monopolistic union more and more precarious. Where trade schools are established, — and notwithstanding the opposition of the unions, they are steadily extending, and will extend more and more in the future, — the unions find it to be their only wise policy to admit into their ranks the men so trained. And even without trade schools, unusually high wages lead a multitude of employers to try to get on without the expensive unionists, and tempt a multitude of other workmen to try their hand at the well-paid jobs; with the result that these mutually attracted parties get together and deprive the union of its monopoly. Reluctantly and unwillingly, even the skilled men are in most cases driven to the policy of the open union.

§ 4. The most hotly debated question regarding unionism concerns the closed shop. Shall all workmen be brought together in unions, and all bargains as to wages arranged by union representatives? Shall non-union men be virtually forced to join the organizations, by being shut out from employment unless they do so? The alternative is the open shop, in which the employers deal with their laborers individually, or at least deal with them irrespective of their being members of the union.

Evidently the closed shop is a powerful weapon in support of the union of the monopolistic type. If the members not only refuse to admit newcomers to their ranks, but refuse to work in a shop with them, the difficulties of getting outsiders, even though these be tempted by exceptionally high wages, are very great. In almost all enterprises, the employer needs a trained and coördinated staff. If the union men leave in a body whenever he employs an outsider, he must substitute another full complement. Even if the work is not very difficult to master, and if plenty of outsiders are attracted by the wages offered, it is at the least a troublesome matter to break them in. If the trade be a skilled one and training in it hard to secure, the union, insisting on the closed shop, has the situa-

tion well in hand. Only extravagant demands will lead the employer to break with them. Ordinarily he will prefer to join with them, pay high wages to keep them content, and reimburse himself by high prices to purchasers. There is an obvious limit to this process, in the conditions of demand among the purchasers; but if the union also limits access to its ranks by restrictions on apprentices and the like measures, it may find in the closed shop a cause — though in large part also the result — of a profitable monopoly position.

Suppose, however, that with the closed shop there is the open union. This would remove at least one of the evils ascribable to the closed shop, — the creation, or at least reënforcement, of a monopoly. If all qualified applicants were admitted in good faith to the union, the primary effect of the closed shop would be simply to enforce collective bargaining. No contracts with individual workmen would then be made. All bargains on wages and the conditions of labor would be concluded through union delegates; but these would represent not any restricted knot of workmen, but simply all who were at work in the trade or establishment.

The case, so stated, is *prima facie* in favor of the closed shop. So much follows from what has been said of the gains secured through unions by laborers. They get better terms by bargaining in this way. They are the most numerous and the most needy members of our modern societies; what improves their condition increases most surely the sum of human welfare.

Let us consider more closely, however, the industrial situation as it would be if the closed shop were universal. A great power would be in the hands of the workmen or of their representatives. That power would be by no means confined to questions of rates of wages. The very settlement of wages involves many other things; not only wages and hours, but the mode of payment, penalties, fines, and numberless details of administration and discipline. Where a trade agreement is drawn up between the representatives of employers and employees, it is never a simple contract dealing with wages alone;

it covers necessarily a multitude of matters of organization. In any case, if we imagine the closed shop to be universally established, one fundamental question is settled for the employer. He has no alternative as to whom he shall employ. It must be members of the union or no one. A strike then simply means complete cessation of operations, and a mere process of waiting until one side or the other is worn out. This, indeed, is what most workmen think a strike (an entirely "fair" as well as a peaceable one) ought to be. They do not regard it as a simple difference about terms, in which one party, unwilling to accept an offer, stands aside and lets the other party make the offer elsewhere. Their attitude — implied rather than explicitly stated — is that no "outsiders" should interfere, and that the places should be kept open for them until they or the employers tire of idleness and finally come to terms of some sort.

The question whether the closed shop, with the open union, is to the advantage of society, depends on the use which the workmen make of the power which it would give them. If used simply to strengthen bargaining power and prevent exploitation (in the narrower sense in which that term is here applicable), unalloyed good ensues to the workmen. But if used to hamper industry, there is much evil also; and, unfortunately, in the present state of mind of workmen and their leaders, there is so much reason for expecting evil of this sort that no dispassionate observer, however strong his sympathies with laborers, can look forward to the universal closed shop without grave misgiving. The grounds for this feeling need some further explanation.

§ 5. The outcome of the universal closed shop, or, in other words, of universal unionism, can be judged from a consideration of the policies now followed by the unions. It cannot, indeed, be judged with certainty, since the conditions would be different from those of partial unionization. But unfortunately there is little ground for expecting that the men's attitude and temper would be altered; nay, rather, they would become

more set, and more obstructive to progress and general well-being.

The inevitable attitude of the hired workman, as already remarked,[1] is to favor arrangements that seem to make work and to oppose those that seem to lessen work. Every improvement, every labor-saving device, means some shifting and readjustment, and hence commonly entails hardship, — perhaps temporary, but hardship, none the less. Once settled in a job, the workman wishes it to last.

One familiar manifestation of this attitude is the limitation of output; that is, the limitation of the amount a man shall accomplish in a given time, as, for example, the number of bricks he shall lay in a day. Such restriction is often defended on the ground that it prevents "driving," — the requirement of excessive stints by employers. Very likely there is a case to be made in favor of it on this ground. But in the great majority of instances it is simply a mode of making the job last, and so a check on vigor and efficiency. It lessens the product of industry. Moreover, it saps the spirit of willing and cheerful activity, and so contributes still more to those factors — in any case many and unfavorable — that make labor irksome.

So it is as regards piecework. The workmen, individually or when gathered in unions, oppose it. Here, too, the ostensible ground of opposition is often that piecework leads to "driving." The rate of pay is alleged to be based on the capacity of some unusually strong or skilled workman, which is then used by the employer as a ground for urging the average man to extreme exertion. Beyond doubt it happens that piecework is thus used as a device for getting too much work, or at all events more work at the same pay; and this supplies one instance more of the individual laborer's disadvantages in bargaining. But, after all, the underlying feeling about piecework is that it increases efficiency, and so seems to lessen the amount of work to be done.

Something of the same sort appears in the demand for a

[1] See Book V, Chapter 51, § 3.

standard rate of wages; though in this case much more is to be said in favor of the trade-union policy. Strictly speaking, that policy is for establishing not a standard but a minimum rate, less than which no member may accept. In practise, however, the minimum rate is apt to be the uniform rate. The general drift among trade-unions is against differences, and so against any higher scale of wages for the capable and strenuous. This drift may be due partly to a widespread egalitarian feeling, a vague questioning of the intrinsic righteousness of that adjustment of reward to efficiency which follows from the strict individualistic principle. But largely it is due to the same feeling that underlies limitation of output and opposition to piece pay, — a fear that the highly paid man will accomplish much, and so will leave less work to do for the rest.

On the other hand, the unflinching adherence to a standard rate, and even to a uniform rate, is to be defended on the ground that it strengthens bargaining power. In the absence of a uniform scale, many an employer will try to whittle away a rate that is supposed to be established, by special agreement made with (and in practise perhaps forced upon) a particular workman or set of workmen. Any sort of discrimination or classification, though ostensibly in favor of the highly efficient, gives color to discrimination against those who are supposed to be less efficient, but who in fact may be simply less able to resist. It is probable, moreover, that the differences in individual capacity between able-bodied manual workmen are not very great, and that the deadening influence which is alleged to be exerted by the standard-rate policy is, in practise, no great matter. Hence this policy, much as it has been condemned by those who see only the bad sides of unionism, has probably done little to fetter general efficiency, and has done something to aid the unions to maintain themselves against covert attack.

The opposition to labor-saving improvements and machinery rests unmistakably on the same ground as underlies more obscurely limitation of output and opposition to piecework, — namely, the dread of unemployment. All hired workmen

(barring perhaps agricultural laborers under some conditions) dread such improvements. In the old days, they rioted, and destroyed the hated competitors. In modern times, a silent, stolid resistance is apt to appear, with a half-conscious endeavor to prevent the new devices from working successfully. It is true that many labor leaders and labor unions have given up the policy of opposing improvements and machines, and advise the members to accept them and to become proficient with them; but this is simply because they submit to what experience has shown to be in the long run inevitable. If the closed shop were the universal rule, no entering wedge would exist for compelling acceptance of the better methods.

The attitude both of employers and workmen, as regards inventions and improvements, is naturally that of trying to appropriate, each party for itself, the whole gain. The employers try to hire the men at the existing rates of pay, to sell the products for the existing prices, and to pocket a higher profit. The men — once they have made up their minds to accept the new ways — try to get for themselves part of the gain. Neither party thinks of the public, and each is apt to talk of the "justice" of having the benefit go to one or the other. Justice, in the sense of promotion of general well-being, demands that the gain shall go to the community, in the form of more abundant production and lower prices; which, of course, is the result of competition among the producers, and especially among the employers. If there is not competition, but monopoly, the workmen might as well gain as the employers. But all experience shows that the benefit from improvements, though accruing first as higher profits to the innovating capitalists, in time filters through to the community. On the other hand, but for the prospect of such higher profits (for a longer or shorter interval) employers would have no inducement to work out the improvements. In this sense, it may be said that the employers, rather than the workmen, are "entitled" to the gains of the period of transition. Stated more simply and with less misleading phrase, the truth is that the

immediate interests of the employers are more in accord with those of the public than are those of any one group of workmen.

The same general remarks are to be made of the attitude of workmen and unions toward discipline. The large-scale industries of our day call for semi-military organization, — for punctuality, prompt obedience, submission to orders. Discipline in the employers' hands rests on the power of discharge. That power the workman naturally resents, — as naturally as he resents machinery that threatens to deprive him of work. The strong union tends to hamper it, and the universal closed shop would tend still more to hamper it. All depends on the character, intelligence, temper, of the men. But the clannishness of class, and the sympathy of the great majority of men in all walks of life for those who have been "caught," make it too probable that the needful sternness of punishment by discharge would be broken down.[1]

No doubt, something is to be said in favor of limiting to some degree the employers' right of discharge. The humane employer always uses it reluctantly. The inhumane or tyrannical or hot-tempered employer often abuses it. The workman has a right to be protected from sudden unemployment because of mere caprice, or ungrounded accusation, or trivial breach of discipline, or activity on behalf of his fellows. The superintendents and foremen who deal directly with the rank and file in large enterprises not infrequently have the vices of the non-commissioned officer; sometimes are brutal, sometimes corrupt, sometimes spiteful. An appeal from their decision, a fair hearing as to the ground of discharge, is reasonably demanded, and is reasonably backed by a union. In adjudicating such questions, there is much to be said in favor of having an established court (like the French *conseils de prudhommes*), or a settled arrangement for conference with representatives of the men. Unfortunately, if the workmen have that full command of the situation which the universal closed shop would give, something more than a fair hearing is likely to be demanded. The

[1] See, for an illustration, Fitch, *The Steel Workers*, pp. 102–103.

power of discharge would be not merely kept within bounds, but destroyed.

Of the various objectionable policies of trade unions, those which hamper progress seem to have had most effect in Great Britain, those which fetter discipline most in the United States. In the former country, trade unions have reached their fullest development, and collective bargaining is most widely practised. In many British trades, it no longer occurs to any one that the individual workman shall bargain with the employer; all is done through the union. But this growth, in many ways gratifying, does seem to have been accompanied in Great Britain by a check on progress, chiefly through limitation on output and silent but effective opposition to labor-saving appliances. The failure of Great Britain to maintain her former leadership in some industries, such as that of iron and steel making, is due in part to trade-union policies which have put a brake on progress. In the United States, this sort of influence has been little felt; partly, perhaps, because of the ingrained habit of accepting and welcoming improvements, but probably in larger part because unionism has hardly ever had complete sway in any industry. A demoralization of discipline has been much more common in this country, especially in railways and similar industries, and has had much more serious effects.

§ 6. This prolonged discussion leads, so far as the closed shop is concerned, to a compromise result. It is undesirable, with the present temper and intelligence of the workmen, that they should have that degree of control which the universal closed shop would give. Yet it is no less undesirable that the employers should have that degree of control which the universal open shop would give. The situation as it actually stands in many industries in the United States is not unsatisfactory, — partly open shops, partly closed shops. The existence of the open shops prevents the unions from carrying their policies to the point of harmful restriction; they must face the competition of the unfettered establishments. The existence of the closed shops prevents the employers from abusing the

advantage which they have in dealing with unorganized workmen; they must face the possibility of unionization.

It seems to be better, however, that no individual shop should be half open and half closed, — employing half union men and half non-union. Employers sometimes take the position that while they will make no opposition to union membership on the part of their men, they will not accede to the strict closed shop, which would compel all to join the union as a condition of being employed. But this plan of letting the men do as they please — join or not join — rarely works well. So eager and vehement is the unionist spirit that where the movement has once taken hold, there is constant nagging of the non-union men. Their lives, and the lives of their wives and children, are apt to be made miserable. Better one thing or the other, — either the closed shop, with the possibility that the employers will "smash the union" if it becomes intolerably restrictive; or the open shop, with the possibility that the employees will strike and unionize if they are not dealt with fairly.

This sort of compromise conclusion is equally unwelcome to both sides. Unionism is the gospel of the labor leaders. It has the sympathy of the great mass of the workmen, whether they be unionists or not; its universal extension is their goal. To most employers, on the other hand, unions and closed shops are an anathema, and in fighting for the open shop they believe they are acting not only in their own interests, but for the better social order. Even the most humane and public-spirited among employers commonly have this feeling. The bitter opposition with which such employers face the union movement is no doubt due in part to the mistakes and extravagances of the workmen; extravagances not only in their endeavors to restrict and control, but in their bearing and temper. The union leader, if he thinks he has the situation in hand, feels the itch of power, and gives his orders in terms which the employer finds intolerable. But in no small part the resentment of the employer arises from his own love of power. Human

nature plays its part on both sides, often more than any close weighing of gains and losses. The generous-minded employer, disposed to do the best he can for his men, yet wishes to do it in his own way. He likes to have a patriarchal position; and precisely this is what the workmen tend more and more to resent. They wish to be dealt with as equals, and to feel that they are in a position to command such treatment. No doubt, the business man who is tactful as well as humane, who meets his employees as men, and who has enough ability and success to be able to pay full market wages without bickering, can carry on the open shop indefinitely without ever having "trouble." It is well that a good part of the community's industry should remain under the leadership of men of this type. But even the best of men are better when they know that it is politic to be good, and the best of employers run the open shop better when they know that the closed shop is a possibility. A great many employers are not of the best type, and as regards them the closed shop is a needed alternative.

A common contention among employers opposed to unionism is that they will deal only with their own men, not with any outsider. In this respect they seem to be quite in the wrong; or, to state it more carefully, the balance of social advantage is against such a procedure. The workmen clearly gain by having their case in charge of chosen representatives, whether or no these be fellow employees; and collective bargaining and unionization up to this point surely bring no offsetting disadvantages to society. As to the immediate employees, there is often a real danger that he who presents a demand or a grievance will be "victimized." He will be discharged and perhaps blacklisted; very likely on some pretext, but in fact because he has "made trouble." Further, the ability to state and argue the workmen's case, and to negotiate with success, is possessed by few. No doubt, it often happens that the labor representatives do not themselves have the needed ability or understanding, and are inconvenient persons to deal with. Sometimes, as has already been remarked, they feel the

itch of power, and like to pose as persons whose orders must be obeyed. But they are the best the men can find, and in the long run it is advantageous that they, rather than immediate employees, should conduct negotiations. The only case in which an employer is clearly justified, on grounds of social advantage, in refusing to deal with them, is where they are corrupt. This case, unfortunately, is not unknown, — when labor leaders are willing to be bribed; though the cases are quite as common where the employers are willing to bribe. The fact that a labor representative is found to be a blatant demagogue, or to present impossible demands, may be reason for promptly closing negotiations, but is no ground for refusing to meet him if once he has been chosen by the workmen to be their spokesman.

§ 7. The attitude of the union members toward the "scab" is the inevitable result of class feeling on the one hand, on the other of that same specter of non-employment which explains the many contradictions between the laborers' point of view and the strict theory of the law of private property and free competition. In the workingman's eyes, the scab is not merely, as he is in the eye of the law, a competitor who enters on a contract for wages which another has chosen to reject. He takes another man's job and deprives that other of work; he is a traitor to the cause of his class. And yet, in the existing industrial organization, there is no other possible way of settling wages than through competitive offer; tempered, doubtless, by collective bargaining, and also by humanity among employers, but fixed in the end through competition. And notwithstanding the pressure of class feeling against the scab, not to mention brutal violence, this in fact does settle wages. A demand for higher wages will not bring them permanently, strike or no strike, if plenty of other men can be found who are willing to do the work on the old terms. In such case an employer's embarrassment in getting together and drilling a new force, and the scab's fear of taunts and a beating, will enable only a temporary victory to be won.

No one openly defends violence; and it is probably true, as the friendly historians of the labor movement say, that it is in the main a stage of young unionism, outgrown and discarded as organization becomes more permanent and effective. But in the United States at least, it has lasted long in some occupations, such as mining and street railways, and has remained (there is too much reason to believe) a deliberate policy. Unfortunately, it is apt to be cumulative in its effects; once begun, it breeds more.

When a strike occurs, especially if it be a sudden one and intemperately led, the employer makes the best show he can of filling the vacant places at once. There are always some floaters, not desirable or desired for permanent retention, who can be used for a while as stop-gaps. There are almost always, in addition, some really desirable substitutes; for in rapidly growing and changing communities a state of perfect equilibrium is never reached, and there is always some labor (as there is some capital) which has not found its place. The question whether a force of efficient men can really be had by the employer at the old wages will be settled only by experience in the long run. The employer may find that he cannot in fact secure and retain good men. But in the first stages of a struggle, the long-run factors are little weighed. The temper of both sides is up, and the employer, though conscious that he is hard put, makes a bluff. The workmen then feel keenly all their disadvantages in bargaining. They cannot wait, especially if their reserve funds are scant. The tactical move of the employer in filling the places with any one that comes along is met by the tactical move of violence against the hated competitor. If the work is carried on in the open and by scattered laborers, — as in the case of teaming or railways, — the likelihood and the effect of violence are so much greater. Then develops the curious phenomenon of the professional strike breaker, — the dare-devil, very likely disreputable in character, who for a bonus will risk limb and life in the first clash with the angry strikers. The mere presence of such a person then

tempts to violence so much the more. Worse begets worse, and a state of something like civil war is threatened.

The "tie-up" is analogous to violence, and often accompanied by it; especially where an industry of pressing importance to the public is affected, as a railway or street railway. The sudden cessation of work, and the more or less disguised threat of brutality against any who would replace the strikers, amount to seizing society by the throat, and calling on it to stand and deliver. Yet the tactical weakness of the laborers, especially as regards the unskilled or little skilled among them, and the not infrequent callousness of the managers of the industries, lead too easily to such a policy. The tie-ups, indefensible as they have been in themselves, have sometimes been the only means of forcing a hearing. They have bred in the managing class a wholesome desire to conciliate their employees.

Such concerted and unnotified cessation of work in the so-called public service industries has been made criminally punishable in Great Britain, and should be made punishable everywhere. But the law serves comparatively little to remedy these evils. In the United States the incredible state of the machinery of justice in dealing with crime no doubt makes the law doubly ineffective. But even if it were decently quick and sure in action, the main reliance must be, as it must always be in a democracy, on the state of public opinion. The extent to which dissatisfied laborers will go depends in the long run on their own state of mind. Their instinctive sympathies will almost always be with strikers. Apparently, it is only experience with anarchy which brings home to them the real meaning of violence in labor movements. Such, at least, is the situation as regards the public service industries. The unpopularity of a great corporation may lead for a while to a toleration of attacks on the public peace. How far the mass of men in a democracy will keep in the long run to the ways of law and order rests on their convictions and traditions as regards the established order of things. If all the trade-unionists and all

the laborers became convinced and militant socialists, any sort of upheaval, with strikes or without them, would become a lever for the great struggle. But in that case much larger and more complex problems present themselves than arise from the unionist movement proper.

§ 8. The present halfway stage in unionism is not likely to persist indefinitely. The movement will probably grow, and a larger and larger proportion of hired laborers will be organized in militant associations. So far as concerns the unskilled and little skilled, this development is to be welcomed. They most need to be safeguarded against overreaching, and they most need the training in common action and in subordination to a common end. Turbulent and badly officered though their unions often are, the organization of the men (and women) makes for social betterment.

As for the minority of skilled workmen, the movement has so much that is narrow and selfish as to command less unqualified sympathy. The sober-minded well-wisher would be glad to see the ends of the unionists attained, — higher wages, shorter hours, restriction of the labor of women and children. But he would have them reached in ways which would benefit all workers, not a particular knot only. Perhaps no better illustration of the difference in attitude can be found than with regard to the demand for the same rates of wages for men and women, — "equal pay for equal work."[1] So far as this means that the artificial barriers in women's way are to be removed, and that they are to have equal opportunities, it is entitled to full support. But its advocacy by the men organized in unions often means, not that they wish the women really to be employed at the same wages, but that the women are to be employed as little as possible; since, on the whole, they are less efficient, and therefore, at the same rates, men will be preferred. What the men really want is a limitation of the employment to themselves. So it is as to restrictions on the labor of women and children. With reference to both kinds, restriction

[1] Compare what is said in Book V, Chapter 47, § 9.

is desirable on large grounds of social policy. But the men who demand them often have a thinly disguised aim to secure more employment of their own. By no means all labor unions or all labor leaders are open to this criticism. Still less are they consciously selfish. Like all men, they are apt to believe that what is for their own advantage is for the common good also. But the fact remains that the compact and well-organized unions of the skilled workmen are entitled, whether in their acts or in their professions, to but a divided allegiance from the social reformer.

The union movement now commands, more than any other, the fervid support of the hired laborers. It is true that by no means a majority of such laborers are now members of unions. But they wish to be, or are disposed to be. The union policy and program have the sympathy of the overwhelming majority. The movement will almost certainly grow to greater dimensions than it now has, and will enroll among its adherents a much larger proportion of the laborers. And this, to repeat, is to be welcomed, notwithstanding all the drawbacks and dangers. On the whole, unions are the most effective instruments to which the laborers can themselves turn for bettering their own condition. They are a potent means, almost an indispensable one, for securing to them a "fair" share in the national dividend, and for preventing the inequalities in wealth from being cumulative in their effects.

Perhaps the greatest drawback to the movement is that the unquestionable gains which organization can bring to laborers lead them to overlook the source from which alone can come a large and permanent advance in wages. The fact that the immediate contentions always relate to a particular rate of wages and a particular set of laborers leads them to think primarily and almost exclusively of the means for bettering the chances of that one group; and this always suggests restriction and limitation. They are naturally led to think and say that higher returns for everybody can be secured through limitation of output and restriction of competition. Workmen and

employers alike think of their special interests alone, and of the ways in which higher wages or higher profits can be got in their own corner of the industrial field. But the basis for a real gain to all the community and all the laborers is in a general advance in productive efficiency, bringing a greater quantity of tangible output. This is most likely to be secured by full competition among both capitalists and laborers. Effective organization, especially if it be organization in open unions among laborers, is not inconsistent with free movement and bracing competition. But, none the less, it tends to deaden individual activity and efficiency, and to cause gain to be sought not through increasing the output, but through manœuvring for a greater slice of the output. It is only with reluctance that laborers and their leaders accept labor-saving devices, as part of the inevitable; they never welcome them, still less promote them.

CHAPTER 56

Labor Legislation and Labor Hours

§ 1. Any established rate of wages or other part of the labor contract is in constant danger of being cut down by grasping or hard-pressed employers; for the bargaining weakness of the laborers makes it easiest to turn to this way of saving expenses. Hence arises the constant effort of trade unions to secure standardization of the conditions of employment, — minimum wages, fixed hours, settled rules. The same sort of standardization is aimed at in labor legislation. The plane of competition is made by law the same for all. Not only is it made the same, but it is intentionally raised. The enlarging moral sense of the community insists that all employers shall carry on their competitive operations on a higher and more humane level.

The typical phase of labor legislation is that for the restriction of the employment of women and children. The perfecting of machinery and of automatic devices has made it possible to employ persons of slender physical strength in the most varied sorts of industries. All that needs to be done is to pull a lever, stop or start a machine, tie a thread. Wherever there are employers who see a profit in the conduct of machine operations with cheap labor, and a laboring class whose members are willing that their women and children should work in the factories, shocking conditions will develop. Children of tender age — but 10, 9, 8 years old — are put to work in the mills, for stretches of 11, 12, sometimes 13 or 14, hours a day. They are employed on night shifts as well as day shifts. Women are employed not only for the same long hours and for night work, but on coarse and heavy work that brutalizes as well as exhausts them. Lamentable conditions of this sort appeared in Great Britain in the early years of the nineteenth century,

as the machine processes made their way; and they have appeared in most countries with the spread of those processes, — in Germany, Austria, France, Italy, Russia. Where a self-respecting population has refused to submit its women and children to such degradation, the processes and the methods of employment have been more or less modified, as in the United States in our earlier days; or the industries using them have failed to take root, as in the Scandinavian countries. The great inflow of immigrants to the United States during the last half century from countries of low standards has so altered social conditions that the evils of children's and women's labor have begun to appear here also with little mitigation, in textile mills, in mines, in glass works.

The machine process and the factory system are not the causes of these evils; rather, they simply take advantage of conditions which they find. The fundamental causes are poverty, pressure for employment, and a low standard of living. In Great Britain the factory system in its early days found ready for its use a mass of people demoralized by a bad poor law, weakened by a long period of food scarcity, cut off from the land by a feudal system of land ownership. In most countries of Continental Europe there are similar low-lying human strata Among these the factory plants itself. But the modern system of production, though it does not create the evils, concentrates them and makes them more serious; and no doubt it increases them, by giving added opportunities. The very fact of concentration, on the other hand, makes it more easy to bring remedial forces to bear, such as factory legislation, compulsory schooling, labor organization. It is probable that in many cases the factory system, even in its first stages, made things no worse for the employees; while in the end it made possible a clear betterment.

It is not within the scope of this book to consider the details of labor legislation. The first Factory Act came in England in 1802; the conditions which it still permitted show how bad were those which it aimed to bring to an end. It forbade the

employment of children under nine years of age as "apprentices" in cotton factories, restricted their time of labor to twelve actual working hours per day, and prohibited night work. This was the beginning of a long series of enactments extending to our own day. The Ten-Hour Act of 1847 was perhaps the most important, restricting the hours of labor for women and young persons (13 to 18 years old) to 10 hours a day, or, as it was afterward rearranged, to 10½ hours on week days, and 5 hours on Saturdays. The Half-Time Act of 1844 was perhaps not less important; it provided that children (under 13 years, — by later legislation defined as under 14) should work but half the time, either full time on alternate days or half time on each day, and that the remaining half should be given to school attendance. In the United States, where legislation on this subject is outside the constitutional powers of the federal government, the most important single state act — because of its influence as an example and a model — has been that of Massachusetts in 1874, limiting the hours of work to ten for women and children. Both in Great Britain and in the United States the limitation of hours for women and children has served in effect to limit those for men also; directly in those industries where the men are employed with the women and children, and indirectly through the influence of comparison and tradition.

Restriction of hours has been by no means the only form of legislation dealing with the terms on which labor may be employed or the mode in which industry may be conducted. Gradually a complete code has grown up in the advanced countries, regulating the conditions of employment in all sorts of ways. Dangerous machinery must be fenced; mines must be ventilated, lighted, provided with appropriate safeguards; sanitation and ventilation must be provided in factories. Industries threatening to health are specially regulated. Thus the manufacture, importation, or sale, of matches made with white phosphorus (which renders the workers liable to a kind of necrosis) is now prohibited in almost all civilized countries.

As Great Britain was historically the first country to enter on labor legislation, so she has remained foremost in extending and enforcing it. The Factory and Workshop Act of 1901, a typical and in many ways a model code, not only affects such matters as have just been referred to, but many others also, — the hours when work is to begin and cease, pauses and rests, overtime, the dates and places of wages payment (the payment of wages in dramshops, for example, is forbidden), the employer's power to impose fines for negligence or damage, the mode in which piecework shall be computed (rates in writing must be posted), and so on through a great mass of detail. In the United States, the laws of the several states vary greatly; many of them are lax; often they are ill-enforced, whether lax or stringent. The backwardness of this country in labor legislation and in its administration is due partly to the *laissez-faire* traditions of former days, but even more to the fact that grave evils are of comparatively recent date.[1] The changed social and industrial conditions of the last generation or two, the influx of immigrants and the growth of manufactures, have rapidly thrust labor problems on us in a new form; and they have not yet been adequately faced. The jealousy between different states, and the fear in each state of hampering its industries in the competition with other states, are serious obstacles to remedial legislation. In this matter, as in others, the inevitable persistence of particularist jealousy raises the question whether the constitutional powers of the federal government should not be enlarged.

For the effectiveness of a system of labor legislation, stringent enforcement is indispensable. There must be a staff of inspectors, well trained and well supervised, and there must be ample provision for prompt penalties on delinquents. Every movement for social and industrial reform depends for its

[1] It is true that hours were very long in the Massachusetts cotton mills, for example, before the Civil War. But until the influx of the Irish after 1846, there was no permanent mill population; the employees were chiefly women who came to the factories for a year or two in order to accumulate some savings. And the pace in the factory probably was slower than in modern days.

success on good public officials, and the prospects for success in any country are gauged by the extent to which it provides such officials. In this respect also, our states are backward. The new and complicated problems of modern industry have come upon them suddenly, and political traditions and political machinery have not been adjusted for dealing with them.

§ 2. The question presents itself: why legislate on all these matters? Why cannot the same results be reached through the efforts of the laborers themselves? Why do *they* not refuse to allow women and children to work, stipulate for fencing machinery, for ventilating mines, and what not?

The answer to such questioning is in part obvious. The workmen simply cannot make stipulations as to the mode in which their work shall be carried on. This is one of the most serious consequences of their weakness in bargaining. The only way in which pressure could be brought on employers toward improving factory conditions would be through the process of the men's quitting the dangerous and unsanitary establishments and seeking employment in those better equipped, — a process of no avail, where all are equally bad. Almost universally the laborer must take conditions as he finds them. The only effective way in which the plane of competition can be raised is by the rigid imposition of the same terms on all employers.

But it is not only helplessness that prevents the workmen from bestirring themselves in these matters. The need of legislation is due largely to their own ignorance and shortsightedness, and, unfortunately, their indifference also. Ignorance and shortsightedness play the chief part in preventing them from concern about the dangers of an occupation. It was not the miners who made the effort for compulsory use of the safety lamp, but the men of science and the social reformers. The rank and file of men are singularly indifferent to danger, or at least singularly slow in taking precautions against danger. Whether it be from bravado, or recklessness, or simple lack of intelligence, the fact is that measures for preventing accidents

must commonly be forced upon them. So it is as to unhealthy trades. Those engaged in them seldom protest, but risk their health with apparent inability to visualize the inevitable future. The initiative in legislation on all these matters has come mainly from social reformers, men of science, physicians.

Social reformers have also been chiefly instrumental in bringing about legislation restricting the employment of women and children. The laboring men (the women and children themselves rarely are able to make their misery known, or their timid wishes heard) have been indifferent or stolid from simple habituation to bad conditions. Long hours, unrestricted employment of women and children, foul air and filth, are concomitants of a low standard of living. They go with low wages and low intelligence, a high birth rate and a high death rate. To lift a population from these conditions calls for strong compulsion from the outside, not only on the employers, but on the laborers also. The parents are themselves often the first to evade restrictions on the employment of children. Legislation on labor conditions must therefore be accompanied by other measures, above all by education. Nothing is so effective toward cleansing and purifying such a social marasm as the bracing atmosphere of democracy, — a sense of equal rights and of free opportunity, and a stir of social ambition.

The moving force in bringing about all the mass of labor regulation and restriction has been the great wave of human sympathy which has come over the civilized world during the last century and a half, and has so profoundly (often unconsciously) influenced the attitude of all men on social and political problems. Altruism has widened in its scope; the suffering of fellow men and of women and children distresses as it never did before. Wretchedness that was accepted as a matter of course a few centuries ago is now not to be endured. We hear much, it is true, of the preservation of the race. Child labor legislation is likened to the conservation of mines and forests. If the growth of children is stunted by premature labor, will not the stuff of the nation deteriorate? This appeal to a

half-selfish motive, to the pride of race and nationality, no doubt has its effect. But the main force is that religion of humanity which aims to make life happier for all. It needs but to be made known that there is abject squalor and misery or joyless children's lives, and there is aroused an eager effort for betterment. The civilized world is not worse than it has been; it is much better; and better most of all in this regard, that all human suffering hurts to the quick, and more and more of public and private effort is given to lessening it.

§ 3. Limitation of hours of labor for men has stood in all countries on a different footing from such limitation for women and children. In England and in the United States no general regulation of the hours of adult men has been undertaken. The men have been left in the main to make their bargains in this regard as best they could. The same is true of Germany. In some other countries of the Continent a maximum working day for adults has been fixed by law for all manufactures, as in France and Switzerland. But the limit permitted (12 hours in France, for example, 11 in Switzerland) has been so wide as to make the general legislation of slight consequence. Particular industries, it is true, have been subjected in one country or another to more stringent restrictions as to men's hours of work; being selected for special treatment sometimes because unusually bad conditions have come to light, sometimes because the laborers in them have succeeded in bringing effective pressure to bear on legislators. The hours in bakeries have been regulated in Germany, and in some American states. In France and in Great Britain the hours of labor for men in coal mines are now limited to eight; and in some of our Western states (Arizona, Colorado, Nevada, Missouri), there has been legislation limiting the hours in all mines to eight. But these are exceptions; in the main there is no direct limitation on the number of hours men may work. By far the most important restriction is that which results from the legislation as to women and children. So far as men are employed in the same establishments, the hours fixed for the women and children are

in effect fixed for the men also, and indeed are sometimes (as in France) made applicable by law to the men in mixed establishments.

In the United States the provisions of the federal constitution by which no person is to be "deprived of life, liberty, or property without due process of law,"[1] and similar provisions in many state constitutions, have been construed to limit the powers of legislatures as regards the regulation of men's hours of labor. "Liberty" has been construed to include, among other things, the right to work on any terms acceptable to the individual adult male. Some degree of regulation is indeed permitted under a vaguely defined "police power," whose exercise is not deemed inconsistent with liberty. But laws forbidding the employment of men for more than ten or twelve hours (and no such law can be effective if the workmen are allowed to contract out) are held to deprive them of liberty to work as they may please. Laws restricting women's and children's labor have not been held invalid, because these classes are supposed to be amenable to control under the police power. Even as to men, some laws restricting hours in particular trades, where grounds of health are supposed to justify an application of this power (as in bakeries and mines) have been held valid. The general doctrine, under which men may not be deprived of their "liberty" to work long hours, results from an interpretation of the term which is easily open to criticism. It is probable that the judges who thus construed it were affected, more or less consciously, by a general prejudice against the laborers' demands. In any case the exact definition of so vague a principle could not but be difficult. The question of constitutional law is not within the scope of a book like the present. But the situation brings into relief a point of principle: are there grounds, apart from constitutional interpretation, for distinguishing sharply between legislation for men and legislation for women and children?

[1] This prohibition is put on Congress by the Fifth Amendment and (what is much more important) on the states by the Fourteenth Amendment.

The only ground for such a distinction seems to be that in the long run it may be better for the men to get shorter hours by their own efforts than by legislation. There are no tenable objections of an abstract or general sort. The same social sympathy which leads to interference in behalf of the women and children may lead consistently to interference in behalf of the men. If it be thought intolerable that women should work more than ten hours, it may be thought no less intolerable that men should work more than twelve, or eleven, or ten. The question is one of degree, and of balance of gain or loss: how far the altruistic impulse can be given sway without ultimate offsetting disadvantage.

Something is to be said in support of the proposition that the men gain more in the end by fighting their battles for themselves. There is a bracing effect in achieving a thing for yourself. Labor organization, labor unions, labor struggles, bring social gain not only in their direct effects on the terms of employment, but in the discipline which they give. The ultimate improvement of the condition of the mass of mankind depends on an elevation of character and intelligence. Though the relegation of progress to self-help is often but a specious means of blocking reform, it remains true that self-help is the most effective kind of help. On such grounds the men may be told to carry on for themselves the struggle for shorter hours. But this certainly is no reason why the state should not set a maximum, as it does in France, — should not say that there are general limits within which the struggle must be confined. Nor is it a reason for opposing legislation in industries where short hours are called for on clear grounds of physical welfare. Thus, in Prussia, labor in mines where the temperature is higher than 28° C. (93° Fahrenheit) may not exceed six hours daily. Such legislation is analogous to that which compels the fencing of dangerous machinery, the proper ventilation of workshops, the detailed regulation of poisonous trades.

§ 4. The demand for shorter hours, and especially for a general eight-hour day, is perhaps the most important item in

the program of labor organizations. Apart from legislation, what is to be said of it?

The same obvious reason which makes one sympathize with the demand for higher wages makes one sympathize with that for shorter hours. It means improvement in the condition of the mass of mankind. And it means improvement at a most important point. Specialized machinery and the division of labor tend, as we have seen, to make labor more monotonous and irksome, less attractive. The best alleviation of this unwelcome but inevitable tendency is by shortening the hours, and increasing the period of leisure, — leisure for rest, for play, for domestic companionship, for the development of higher faculties and purer pleasures. The cynical objectors sometimes say that leisure is in fact used by the mass of laborers for drunkenness and demoralizing idleness. But in fact drunkenness is an accompaniment of long hours, and of the things that go with long hours, — low wages, bad workshops, degradation. It is true that with shorter hours there should be other agencies for better living: improved education, libraries, playgrounds and healthy amusements, substitutes for the dram shop. Shorter hours, — shorter than are now traditional, — can be made to bring without fail an overwhelming balance of gain in happiness.

The debatable question concerns the effect of shorter hours on wages. The demand for them is invariably combined with a demand for the same wages; less work, or at least less hours, but not less pay. Are these combined demands reconcilable? Will not shorter hours lessen the product of labor, — the source from which wages must come — and so bring inevitably a lowering of wages?

Shorter hours do not necessarily lessen the output. Where work is done by the piece, men may often accomplish as much in eight hours as in ten. Even where work is done, not by the piece, but by the day or hour, this is often feasible; though such an outcome is not probable in the absence of the stimulus which piecework gives, since the rooted disposition to make

employment then operates without check. Even where machinery sets the pace, a reduction in hours may be offset by a gain in efficiency. Machinery never fixes the pace quite without regard to the intelligence and watchfulness of those who set it in motion. An alert and wide-awake laboring force may turn out as much in ten hours as a weary one in twelve.

But all this holds good only within comparatively narrow limits. Pieceworkers and skilled mechanics can, perhaps, do as much in eight hours as in ten; but they cannot do as much in seven hours or in six. Factory operatives can often do as much in ten hours as in twelve; but it is very rare that they can do as much in eight as in ten. The universal introduction of the eight-hour day would mean (other things unchanged) a lessening of the national dividend.

Other things unchanged: but other things may change. Above all, the progress of invention and of the arts may increase the general efficiency of labor, and so enable hours to be reduced without lessening the output. This is what has happened in the civilized world during the last half century; this is what we may confidently expect in the years to come. The tendency in all civilized countries has been to reduce working time. Factory hours in England and in the United States were 11 or 12 (more commonly 12) until the middle of the nineteenth century; they are now usually 10 in both countries, with a half holiday on Saturday in England. Unfortunately, there are many industries in the United States in which the hours now are more than 10, as in the textile mills of the South and the iron and steel industries of Pennsylvania; a result due to the same cause which has led to the abuses of women's and children's labor in these regions, — a laboring class with a low standard of living. In Germany the usual hours were 12, 13, 14, even 15, until after the middle of the nineteenth century. They are now for the majority of workmen as low as ten, and in few cases are more than eleven. This general reduction in hours, *pari passu* with a general advance in wages, has been due to the gain in productive

capacity. John Stuart Mill, in a much quoted passage written in the middle of the nineteenth century, declared that it was doubtful whether all the inventions had diminished the toil of a single human being. That doubt can no longer be expressed; happily it is clear that for multitudes of men and women toil has been diminished.

And it will be diminished more, and ought to be diminished more. With the general increase in the productivity of labor, the working people have a choice between several alternatives: higher wages with the same hours; lower wages with less hours; or a middle course, — somewhat higher wages and yet somewhat lower hours. This middle course is the one which they have chosen. "Chosen" is a misleading word; for obviously there has been no conscious or deliberate choice. There has been simply a vaguely guided steady pressure for better conditions, — for both higher wages and shorter hours. The successful attainment of both has been due to continued struggle and continued compromise, and at bottom to those very labor-saving devices which the laborers themselves commonly oppose. The gain has come by slight successive steps, as almost all industrial changes do, — first in one trade, then another, first in one country, then another. The skilled mechanics get short hours first, for the same reason that they get higher wages first, — because the demand of the rest of the community for this sort of labor is high as compared with the available supply of it. That one group of laborers, thus favorably situated, can secure both short hours and high wages, does not prove that all can do the same; but none the less it is true that this aristocracy among the laborers has been able to wrest its advantages because there have been improvements both in the ways of doing their special work and in those of doing the work of almost all other laborers.

When once the general level of wages has got above the minimum for mere subsistence and physical efficiency, a diminution of the hours of labor is, as has already been said, the best form of higher wages. It makes not only for some leisure and

some enjoyment of life, but for better intelligence and better character. The demand for a universal eight-hour day is entitled to all sympathy and support. Very likely the time is not ripe for it, even in comparatively advanced countries like the United States and England. It could not probably be introduced in all industries without a loss in output and so in wages. But it is a goal which the laborers are right in keeping ever before them, and in pressing for whenever favorable conditions exist. No doubt here, as in so many cases, they that have, find it easiest to secure more. The skilled mechanics, whose wages are already high, get the eight-hour day soonest, and without any reduction in pay. Those industries in which operations are continuous night and day, — as iron and steel works, — and in which the twenty-four hours are often divided between two shifts working twelve hours each, need the shorter work period most of all. The only decent arrangement here is one for three shifts, each working eight hours; an arrangement common in the mines of our West, and to be wished for in all industries working continuously. The favored mechanics, selfish and even obstructive to true progress as they sometimes are, in this case at least set a good pace and offer a stimulating example to the rest. When we survey the steady progress in reducing hours which has been made in the last half century, and consider how strongly the aspirations of the workingmen turn to this form of industrial gain, we may hope that another half century, perhaps another quarter century, will bring the widespread adoption of the eight-hour day.

§ 5. Where there are very low earnings and the conditions that usually accompany low earnings, such as long hours, bad workrooms, harsh bargaining with the weak, the question arises whether there may not be regulation of the plane of competition by fixing minimum wages as well as by regulating hours of labor and the other terms of employment.

The demand for this further form of labor legislation is pressed more especially for the so-called "sweated" trades. That term is loosely used, and has come of late to have a wider

meaning than when first applied. Originally it described a system of subcontract and domestic industry, work being parcelled out on piece terms and done at the homes of the workers. The making of clothing continues to be the typical industry. Machinery and large-scale production in great establishments, which have so completely revolutionized the making of textile fabrics, have as yet been applied comparatively little to the cutting and sewing of garments. The wholesale dealers and the tailors parcel out these tasks, especially that of sewing, to subcontractors, and these in turn parcel them among men, women, and children who do the work at their homes. The instance now most striking in the United States exists in the East Side of the city of New York, where hundreds of thousands of newly arrived immigrants, mostly Russian Jews, are engaged by subcontractors in sewing vast quantities of clothing for the American people.

Wretched conditions often appear in this organization of industry; but they do not arise from it by necessity. The earnings of the so-called sweated are by no means universally low. They are so when very many compete for the work and can turn to no other sort of work. Such is the situation in some parts (though not in all) of the New York clothing trade; since the hordes of newly arrived immigrants are ignorant of the language and of the country's possibilities, find their compatriots doing this thing, easily join them at it, and can turn to nothing else. The subcontractor may then be what he is pictured in popular imagination, — a prosperous and unscrupulous person who takes advantage of the helplessness of the sweated and grinds them to long hours and pitiful wages. But quite as often he is himself a poor devil, competing with others no less poor, and unable to extricate himself or his employees (if such they can be called) from the system. There is much to be said in favor of legislation which shall prohibit work in tenement houses, not only on grounds of health, but for the better supervision and regulation of labor conditions. In the clothing trade, the improvement of machinery operates

in any case in this direction; it is becoming more and more possible to make garments with profit under factory conditions.

But, whether in factories or in domestic work, there will be low wages wherever there is a low-lying non-competing group, and then there will be long hours as well, unsanitary conditions, overreaching of the weak and ignorant. People have come to speak of "sweating" wherever there are these lamentable conditions. And in all such cases the question presents itself, how far shall the competitive process be allowed to work out its results? May not the law set a minimum of wages, below which no one shall employ or be employed? Shall it not be required that every one who works is to receive at least a "living wage"?

There is much haziness in the talk about a "living" wage. Those who use the phrase do not mean by it an absolute physical minimum. They have in mind a standard of fit or decent living; and such standards vary from age to age and from country to country. What is regarded as a living wage in the United States is more than what would be so regarded in Germany or in Italy. Like standards of "just" wages, this is in reality something to which men have become habituated, and which reflects the general attainment of a given stage of well-being. The feeling that none should fall below such a "living" wage rests at bottom on the same basis as most people's feelings in favor of social reform, — a sympathetic wish that all should share in the gains from progress within the bounds that have become accepted and familiar.

The demand for legislation establishing a minimum rate of remuneration does not necessarily involve questions of principle different from those considered in the preceding sections; and yet, if pushed to its farthest consequences, it might easily raise a new question.

As with legislation on hours, factory conditions, and the like, a compulsory minimum wages rate might serve simply to regulate the plane of competition. All employers would be affected alike; no one could undersell the others by cutting below the

established rate. There would be obvious difficulties of administration, — attempts at evasion, to be met only by a staff of inspectors, by publicity, by support from public opinion. Such difficulties, serious anywhere, would be especially serious in a country like the United States, whose methods of legislation and administration are still crude. But they involve no new questions of principle.

A more fundamental question, yet still not one of an essentially novel sort, would be, how to deal with the unemployable. There would unfailingly be a certain number not capable of earning the minimum, — the aged, feeble, maimed, the dissolute or half dissolute. It would be impossible to compel employers to pay the minimum to those whose services were not worth it. But it is a fair question whether it is not a merit in the proposal, rather than a defect, that the community would be compelled to face squarely the problems of decrepitude and degeneration. Among those who are incapable of work or but half capable of it, two classes may be distinguished: those who are helpless from cases irremediable for the individual, yet not cumulative as regards society, such as old age, infirmity, disabling accident; and those helpless from causes that tend to be cumulative, such as congenital feebleness of body and character, alcoholism, dissolute living. The first class may be dealt with charitably, or provided for by some system of insurance. The second class should be simply stamped out. Neither the feeble minded, nor those saturated by alcohol or tainted with hereditary disease, nor the irretrievable criminals and tramps, should be allowed at large, still less should be allowed to breed. We have not reached the stage where we can proceed to chloroform them once for all; but at least they can be segregated, shut up in refuges and asylums, and prevented from propagating their kind. The opinion of civilized mankind is rapidly moving to the conclusion that so far at least we may apply the principle of eugenics, and thus dispose of what is the simplest phase of the problem of the unemployable.

But there is another aspect of that problem, — one that

does involve a new principle. What are the possibilities of employing at the prescribed wages all the healthy able-bodied who apply? The persons affected by such legislation would be those in the lowest economic and social group. The wages at which they can find employment depend on the prices at which their product will sell in the market; or in the technical language of modern economics, on the marginal utility of their services.[1] All those whose additional product would so depress prices that the minimum could no longer be paid by employers would have to go without employment. It might be practicable to prevent employers from paying any one less than the minimum; though the power of law must be very strong indeed, and very rigidly exercised, in order to prevent the making of bargains which are welcome to both bargainers. But in any case it would be quite impracticable to compel payment of the minimum to all who applied, irrespective of their numbers.

Back of this movement, in other words, is the specter of Malthusianism. The danger of pressure from uncontrolled increase of numbers exists in modern societies chiefly for the lowest stratum. In the United States it needs to be considered as regards the newly arrived immigrants and their first descendants.[2] No legal minimum of wages can avail if numbers increase so as to bring an ever growing competition for employment. How far this obstacle would really stand in the way of minimum-wage schemes would depend, as we have seen, mainly on the extent to which the stir of ambition reached all classes, low as well as high. Freedom, education, broadening of opportunity, the vulgar as well as the refined forms of the love of distinction, — all the influences of democracy — make it probable that increase of numbers will not destroy the possibilities of permanent uplift. Yet, though we may have hope and even confidence on this score, we cannot be sure how far the forces of nature may be curbed.

[1] See Book V, Chapter 48, § 2.
[2] Compare Book V, Chapter 53, § 2.

Whether this fundamental difficulty will really present itself depends on the mode in which minimum wages are attempted to be fixed,—whether at a rate conforming on the whole to market wages, or at a rate substantially higher. The probabilities are that in this matter, as in the essentially similar one of general compulsory arbitration,[1] the divergence from existing conditions will be slight. The minimum wages fixed by law are likely to be virtually in accord with competitive wages for the lowest group. They will not modify the essentials of the wages scale as it is; they will rather standardize current rates. They will aim at wages which are "just" and in accord with a "minimum" standard of living, in the sense that they will tend to aid and strengthen the forces that prevent weak bargaining and exploitation. Such at least has been the case in the much-discussed legislation of the Australian colonies, especially Victoria, and very recently (1909) in the Minimum Wages Act of Great Britain. It remains to be seen whether this movement, like others of which enthusiastic people speak in large terms, will be carried to the stage where it will encounter obstacles fundamental in the system of private property and competitive industry.

[1] See the next chapter, Chapter 57, § 6.

CHAPTER 57

Some Agencies for Industrial Peace

§ 1. The rapid growth of the militant movement among laborers, the increasing tension between the opposing groups of employers and employed, the losses and disturbances from strikes and lockouts, have set people to considering ways of lessening the causes of strife. Among the proposed remedial devices are profit sharing, welfare arrangements, sliding scales, arbitration. To the main features of these and to the principles which must be borne in mind regarding them we may now give attention.

Profit sharing is a device for binding together the employer and the employees engaged in a given enterprise. Trade-unionism looks to a horizontal division: all the employees in a trade, scattered in various establishments, are to be united in common action against all the employers. Profit sharing looks to a vertical division; the employer and the employees of the single establishment are to be united, working together for the common welfare of their compact group, sharing the gains and perhaps the losses. (It is conceivable that both sorts of combination, the horizontal and the vertical, should go on side by side,—that the workmen should be united with all their fellows for common action on some matters, and with their several employers for common action on others) But in fact they usually are found incompatible. Those employers who enter on profit sharing are averse to participation by their workmen in trade-unions, and indeed sometimes adopt profit sharing with the design of counteracting the union movement. The unions, on their part, are opposed to profit sharing, or at the least suspicious of it, because it tends to make the workman

interested chiefly in the welfare of his immediate fellow-employees, not in that of all workmen of the trade or locality.

Profit sharing aims to distribute among the workmen some part of that residual share in distribution which ordinarily goes *in toto* to the business man. In the typical profit-sharing scheme, no endeavor is made to modify interest or ordinary wages. The usual provision is that interest shall be paid to capital at the current rate (say five or six per cent) and that wages shall be paid to the workmen at the current rates. Usually, too, it is provided that the managers, even though they be also the owners, shall be allotted a stated sum as salary, — as wages for that labor of management and superintendence which obviously is part of the current work of the enterprise. The surplus left after paying all these shares is then to be divided between employers and employees. Sometimes half of it goes to the one, half to the other, as in the well-known case of the Briggs collieries in England (a case in which profit sharing was given up because it failed to prevent strikes). Similar in principle, but more favorable to the workmen, is the division in the famous Leclaire house-painting establishment in Paris, where the proprietors get one quarter of the net surplus, the workmen three quarters. Sometimes, as with the Nelson Manufacturing Company of St. Louis, the division is based on the proportion which the total capital invested bears to the total amount paid out in wages in the course of the year. Sometimes, as in another French example no less noted than Leclaire's, that of the Godin metal-working establishment at Guise, the division is in the proportion which the total interest paid on capital bears to the total amount paid in wages, — evidently an arrangement much more favorable to the workmen. Still another variant — and there are numberless variations in detail — is that the same dividend shall be paid on wages as is paid on the stock of the enterprise (it being conducted under corporate organization). This arrangement has the advantage, from the employer's point of view, that it gives no occasion for any inspection of the books, by way of con-

trolling the calculation of net profits; for the rate of dividend on stock is a comparatively public matter in any case. In all cases, however, the partition among the individual workmen is according to the wages severally received by them. Each one gets a share based on the proportion which his wages bear to the total paid out in wages to all; so that those who are highly paid and steadily employed get the largest amounts of bonus. Steady employment, to be sure, is usually a condition of any bonus at all; as a rule, only those who have been members of a permanent staff are admitted into the profit-sharing scheme.

The amount which goes to the workmen is not necessarily paid to them in cash. A part of it, even the whole of it, may be kept in the enterprise as working capital, but credited to the workmen, and thereafter entitled to interest and profits like other capital invested; the interest and profits being paid in cash, but the accumulating bonuses retained as additions to capital. In the great Godin concern no part of the workmen's shares in profits was paid in cash, but all was put into the enterprise, being used for buying shares in it; with the result that in process of time the workmen themselves became the main owners, and the arrangement became one not so much for profit sharing as for coöperative production. The same result was reached eventually in the Leclaire establishment. There only part of the bonus was paid in cash, the rest being turned over to a workmen's Mutual Aid Society and invested in the enterprise for the benefit of that Society. Indirectly, but none the less effectually, the workmen through the Aid Society have become the main owners; and this arrangement too has become one for coöperation. In the Nelson Company, also, the workmen's share of profits must be left in the business; and the hope and expectation of the head of the enterprise is that here also profit sharing will be eventually replaced by coöperation. But such an outcome, though aimed at in some of these conspicuous cases, is no essential part of a profit-sharing scheme. Coöperation presents different problems; for it endeavors to get rid of the business man, not

simply to strengthen the bonds of interest between him and his employees.[1] For the great majority of workmen, the most effective way in which profit sharing can strengthen those bonds is to pay their share in cash once for all; and, except in France, this is the most common arrangement.

Profit sharing has been practised, and is practised, on a considerable scale in France. The habitual thrift of the French, and their constant eye to small sums, makes it more attractive to many workmen there than it seems to be in other countries; and a few conspicuous examples of success, as in the enterprises of Leclaire and Godin, have contributed to the spread of the movement. In other countries it has not had so much vogue, and on the whole cannot be said to be extending in any noticeable degree or to promise any far-reaching influence on industrial development.

§ 2. Profit sharing was at one time proclaimed as a solution of the labor problem. It was expected to be widely adopted and to bring general industrial peace. Slackened growth of the movement, and a more critical consideration of its methods, have dampened these expectations. Yet there are still earnest advocates, who believe that it has large possibilities.

The plan will not be widely adopted unless it pays the employer. It is true that there are generous-minded employers who will adopt such a system, even though it brings no pecuniary gain. This has been the basis of some of the most conspicuous and long-continued cases. There large enterprises have been conducted by men of strong altruism as well as of high ability, who have gathered about them a staff of managers and workmen imbued with the same spirit. Unfortunately this spirit is rare. Were it common, the whole aspect of the economic world would be changed. The immense majority of business men, and of workmen too, are not disposed to hand over to others larger gains unless they see some advantage therefrom to themselves. So far as profit sharing is concerned, the advantage, to be sure, is not necessarily a direct pecuniary one.

[1] See below, Chapter 59.

Freedom from labor struggles and strikes has come to be of indirect but considerable pecuniary advantage. Conceivably there may be an advertising advantage; people will be led to make purchases by preference from those who are supposed to be generous with their workmen. But some gain of a fairly calculable sort must accrue if the profit sharing plan is to prevail widely.

The one important and permanent source of pecuniary gain would be in greater efficiency on the part of the individual workman. Knowing that he is to have a share in the profits, he may be expected to work more conscientiously and more assiduously, to save materials and to care for tools. Thus he will contribute as much in additional output as he receives in bonus; not only as much, but even more; so that the employer after paying the bonus, will find output and presumably profits increased. No doubt there is possibility of improvement of this sort. The ordinary wages plan often entails waste, from the slackness and carelessness of the workmen. The waste is not only of a material sort, but of a spiritual sort, since it deadens the interest and satisfaction from labor. Any scheme that really promised to eliminate or lessen this double waste would be welcome from every point of view.

There are circumstances under which this welcome result may accrue. Where the industry is considerably and directly affected by the way in which the laborers do their work; where those laborers are intelligent enough and persistent enough to keep to better ways, even after the novelty of the scheme has worn off; where the employer steadily gives them a substantial share of the accruing gains, — there the conditions are sufficiently favorable for profit sharing. Such seems to have been the situation in Leclaire's house-painting enterprise. There the work was widely scattered, difficult of supervision, and much affected by the care and skill of the individual workmen; the employer was capable and warm-hearted, earned the confidence and loyalty of his men, and gathered about him a staff above the average in intelligence and character.

In most industries of modern times the conditions are not thus favorable. It may be a question how far deficient intelligence and farsightedness in the average workman would stand in the way, other things being propitious; but other things are not propitious. In the typical modern enterprise, there is a very uncertain connection between the employee's individual care and activity, and the general outcome of the business. Though he do his best, profits may be wiped out by a turn in the market or by the employer's bad management. Conversely, though he do the usual humdrum thing, profits may be high. This is the essential economic weakness of profit sharing. The final outcome in the way of profits depends not only on the efficiency of the individual employees, but on a multitude of other factors. To this must be added the circumstance that, with the increasing concentration and standardization of technical operations, it becomes more and more easy to parcel out the stints and to supervise the men. Work is commonly done in factories with much regularity and routine. Even where there is not piecework, it is possible to fix the normal performance for each man. The power of discharge is a more coarse and cruel stimulant to efficiency than a bonus from eventual profits, but it is more direct and, unfortunately for most men, more effective.

To repeat, unusual employers can achieve unusual results. The spirit of the leader permeates a business enterprise, as it does a regiment or a school. Even industries in which the conditions seem unpromising — where the connection between individual efficiency and eventual profits is remote — have been conducted on the profit sharing plan with brilliant success by able, inspiring, high-minded men. The list of enterprises in which the scheme has been continuously maintained shows a surprising variety; they cannot be said to have industrial characteristics in common. The inference is the stronger that the personality of the leaders has been the chief factor. Where once established, the system long maintains itself, even after the death of the founder, for the same reason that any business

organization continues to run on when once it has got its impetus. Probably the founder has enlisted associates who are like himself in character and spirit. That profit sharing will spread widely is not to be inferred from its long maintenance in individual instances.

The other less immediate gains to employers from the plan are not of so great importance as the direct effect on output and profits. The prevention of strikes has been a strong motive with some employers. But the fact that the trade-unions look on it askance, and the growth of other methods for linking the interests of employer and employee, have made it of diminishing promise on this score. Sometimes, as has already been noted, an advertising advantage is supposed to be secured. A business concern turning out an article widely used by the general public ingratiates itself by what is supposed to be kindly and generous dealing with its employees. It is a most commendable form of advertising, if the dealing be really generous and kindly. But unfortunately it is far less effective than the familiar blatant sort.

The prospects that profit sharing will be universally adopted are *nil*. Even the prospect for wide spread is slight. For good or ill, the horizontal division between employers and employees is becoming sharper. The decay of semi-patriarchal conditions, and the spread of the trade-union movement, make against close vertical association. This does not mean that relations are necessarily becoming more embittered, or that industrial peace is harder to attain; but that its attainment will not be much promoted by this particular device.

§ 3. Profit sharing, however, is only one way of reaching the desired results. It is, as we have seen, not a very direct way. Other devices to the same end may be tried, and some of them seem to have more promise of effect than profit sharing. "Gain sharing" is a generic phrase often applied to them. Piecework pure and simple is an obvious case. Sundry schemes have been devised by ingenious managers: premiums on output per man or per group of men; bonuses on savings of

materials, oil, fuel; and the like. Simplest and perhaps most effective of all is general good treatment combined with general good discipline. Some tautness of organization, some threat of punishment through discharge, there must be, so long as men are hired by others for profit. But a humane and farsighted policy can do much to mitigate the inevitable drawbacks. Prompt payment of wages at the going rates, ready attention to complaints, straightforward and nonpatronizing dealing, wise selection and supervision of the understrappers, well-equipped workrooms, and good provisions for comfort, — all these are helpful. They are helpful most of all when guided by the right sort of personality; for, as has just been said, the personality of the industrial leader runs through his entire establishment.

What are called "welfare" arrangements play a considerable part in the large-scale industries of our day. Such are schools and libraries in connection with the enterprises; light and ventilation in factories; good toilet rooms; decent places for the midday meal; gardens, playgrounds, and club rooms; dwellings (when supplied by the employer) of good design at moderate rentals; pension plans and mutual aid societies, aided and subventioned by the employer; and so on indefinitely. All these are good, not as "solutions" of the fundamental problems, but as mitigations of existing evils. The increasing adoption of methods of this sort is in part but one manifestation of that growth of altruistic feelings which, as we have seen, underlies labor legislation and the whole movement for social reform. In no small degree it is due also to pressure from labor unions. The fact that workmen are formidably organized makes it pay to minimize discontent. Whether due to humane spirit or to cold-blooded calculation, this mode of "fighting the unions" may have our cordial sympathy. If the competition among employers and salaried managers brings to the fore those who are not only energetic and capable, but farsighted and of good heart, so much the better. Development in this direction, at all events, seems more likely to take

place than that of profit sharing in the strict sense, and it promises more for industrial peace in the future.

§ 4. An entirely different device is that of the sliding scale. By this, as by profit sharing, an automatic sharing of good results and of bad is sought; but in a different way. Wages are made to vary with the price of the product, going up as the price rises, declining as that falls. A minimum rate, below which wages shall in no case fall, is usually set, and a price of the product is agreed on corresponding to this rate. As the price rises above this point, wages also go up, by stages agreed on in advance; and as the price declines, wages fall, but only until they (perchance) reach the minimum.

The method is of course applicable only where a homogeneous product is turned out, and where the price of that product can be ascertained readily, say from published market quotations.[1] Coal of uniform quality (or with standardized grading) fulfills these conditions. Hence we find the sliding scale in use among the coal mines both of South England and Wales, and of North England. It has been applied similarly in the anthracite coal industry of the United States, in earlier times (1870–1872) and more conspicuously after 1902, when it was put into effect after the great strike of that year. It has been applied to the iron trade, both in the United States and in England, where standard kinds of crude iron are turned out. A case in this country has been in the cotton manufacture of Fall River, where the product is chiefly print cloth of uniform quality and recorded price. Here wages were made to go up and down, not according to the price of the print cloth itself, but according to the "margin" between raw cotton and cotton cloth, — that is, according as the current price of a piece of cloth exceeded by more or by less the price of the raw material used in producing it.[1]

The sliding scale seems at first sight to be out of accord with the general methods of the wages system. The principle

[1] It is not without significance that this Fall River arrangement, welcomed at first by the operatives because it worked to their advantage, was later (1910) given up by them when it came to work to their disadvantage.

underlying the usual arrangement (if principle it can be called) is that the employing business man takes the risks of enterprise, and that the employee does not. The employee gets once for all a stipulated sum, which is independent of the price obtained for the particular goods sold, as it is independent of the profits of the particular employer. If the product in the industry or establishment falls in price, the employer bears the brunt of the loss. If coal or iron or print cloth falls in price, the presumable consequenees might be outlined thus: a decline in the profits of the employing capitalists, then a reduction in output, then a transfer of workmen to other occupations, and an eventual readjustment to the price normal for that article; but through it all, no changes of wages from the level fixed by the general forces which determine wages.

But this very statement of the presumable or "theoretical" consequences of the usual wages arrangement indicates why the sliding scale may commend itself both to employers and to workmen. These consequences are conditioned on mobility of labor and capital. For considerable periods there is little mobility; and those engaged in an industry often think there is less than in fact exists. When there are lower prices and lower profits, the decline in output, though it comes, is carried out slowly and reluctantly. A shift of workmen away from the industry takes place no less slowly and reluctantly. Hence employers and employees are in a sort of *de facto* product sharing situation. Both are for the time being settled in the existing employment, and between them can get out of it only what the output of the industry in gross makes possible. It is true that a prolonged period of high prices and high wages tends to attract capital and labor into the industry, and so to bring again a lower range of returns; while conversely a period of low prices and low wages has the opposite effect. But these further consequences are commonly disregarded by "practical" people; for they rarely look beyond the present and the very near future. Only a small number of farsighted business men and a few economic students give thought to eventual results.

Most persons think of the laborers and the employers in a given industry as committed to it once for all. Friction is avoided and the continuous conduct of operations promoted if there is agreement in advance that both wages and profits shall fluctuate, in some degree at least, with the price of product.

§ 5. Still another device for preventing strife is arbitration. Why not refer disputed questions as to wages and terms of labor to an impartial judge, and abide by his decision?

Arbitration may be private or public. If private, it may be sporadic — provided for the particular exigency; or permanent, through boards or judges arranged for in advance. If public, it may be with powers of recommendation only, or with powers of compulsion. The most widespread forms of arbitration are those private arrangements which are permanently established and those public boards whose powers are for recommendation only. And these two, again, though different in origin and in formal position, work in practise much in the same way and with the same degree of efficacy.

Disputes concerning wages, hours, and other matters very rarely involve any large question of principle, or any attempt at far-reaching disturbance of existing conditions. They turn on wages a few per cent higher or lower, hours a little longer or shorter. By "fair" wages most people mean the current market rate, or that rate which would obtain if competition worked out all its results smoothly and promptly. When employers and employees dispute as to what is "fair," they are commonly not very far apart; and commonly each side would lose less (certainly for the immediate future) by accepting the terms offered from the other side than by a strike or lockout. The frequent outcome is to split the difference, often no great difference; and this is much eased if the whole dispute be referred to an impartial arbitrator or board of arbitration.

Not only is there usually a material gain to both sides by turning to arbitration, but there is an immense gain for pride and temper. Men who have backed their demands by threat and ultimatum find it difficult to retreat to a halfway position,

even though they know that it will be better to do so. The existence of a respected standing tribunal serves in industrial conflicts as the Hague Court of Arbitration serves between nations: it enables the parties to withdraw without loss of pride from a bellicose attitude.

There are, indeed, some questions of principle which it is difficult to refer to arbitration, and which it would be no less difficult for an arbitrator to settle. Such are questions as to the recognition of the union: shall the employer deal with his men one by one, or in a body through their chosen representative? Here, as we have seen, the balance of social gain, and so the answer to the question of principle, is against the frequent contention of the employers. But an arbitrator would have to discuss the deepest problems of economics and ethics to give a satisfactory answer to them, and certainly would fail to convince both disputants even if he attempted such a discussion. Again, as to the closed shop: shall the employer agree to employ only union members, and discharge the non-union men? Here the balance of social gain is doubtful, and the answer to the question of principle hard to give. Such matters can never be settled by arbitration. If the employees are really set on the closed shop, they can get it only by insistence and fight; and whether they will succeed in getting it and keeping it, depends on the accumulating experience with the ill and good of the practise.

But, to repeat, most disputes, and especially those which are likely to be referred to arbitrators, turn on matters of less profound bearing, — wages, hours, shop conditions, fines, and the like. Agreement on these is facilitated by arbitration through permanent private boards, or public boards.

Permanent private boards rest on trade agreements. They depend on the existence of organization among employees as well as employers. They are an outcome of collective bargaining. Carried out with rigorous consistency, they entail the closed shop; since they assume that no agreements are made by individual workmen. None the less, trade agreements may

work in practise without the universal closed shop, since union terms and bargains set a standard to which the nonunion establishments tend to conform. Such compacts, as they have developed in course of trial, provide for regular meetings, for a settled course of procedure, and for reference to arbitrators of disputed points. It is not necessarily agreed in advance that the decision of the arbitrators shall be binding. Their function ~~may be that~~ of conciliation rather than of arbitration. Indeed, it is probably better so; since in any case they can have no power to enforce an award. Whatever the precise stipulation as to arbitration, such compacts, to repeat, depend on permanent and well-organized trade-unions. It is in so far true that the unions make for industrial peace. They ease the process of bargaining, make for deliberate action, lessen the probability of frequent and unruly strikes. No doubt, this combined action of employers and employees brings a further danger, — that the two will unite in a tight organization, keep out other employers and employees, and levy on the public by restricting supply and exacting a monopoly price. The seriousness of this danger depends on the extent to which competition from outside employers and nonunion workmen can be shut off. We have seen that, as between workmen, the drift of industrial change is against the permanent maintenance of a monopoly position. As between the employing capitalists, this comforting assurance is by no means so clear; but their striving for combination raises social questions of a different kind from those here under consideration. —

The same beneficial result, of lessening the number of industrial disputes, is promoted by public boards of arbitration, such as are established in many of our states, in France, and in England through the Board of Trade. These are commonly boards of conciliation as well as of arbitration. They are authorized to offer their services as mediators and conciliators when a dispute occurs, and to make public report of their action, — sometimes an effective method of bringing public opinion to bear in aid of a settlement. As boards of arbitration, they

provide a standing tribunal to which the disputants can refer, and so can save their pride and probably their money. Their efficacy depends largely on the character of the individuals appointed to this delicate task. Even with the best of appointees, and with the best exercise of judgment on their part, there will be some disputes, very possibly a large proportion of the whole, which will not be referred to them. Among those which are referred, or are taken in hand without any reference by the disputants, many must fail of settlement by arbitration or conciliation. The system is no panacea against strikes or losses. On the other hand, even with limited success (and the best of our American boards, that of the state of Massachusetts, has had but limited success) it is well worth while. Though many grave cessations of work have taken place in spite of the standing public boards, they more than repay the expense of maintenance if they succeed in preventing a moderate number of struggles. Though but a palliative for industrial ills, arbitration is none the less helpful.

Publicly appointed boards of arbitration have one intrinsic advantage over private boards. On the latter it is common to have a member selected by the employers, another selected by the employees, and a third selected by these two (or by some other method supposed to guard against bias). In practise, this leaves the decision virtually to the third member, and loses the advantage of real contribution by all the members to fair-minded consideration. Public boards, especially when appointed in advance and without reference to the particular controversy or trade, are more likely to bring this advantage. None the less, the contestants are apt to prefer private boards, for the very reason that each wishes to have among the judges at least one advocate.

§ 6. Quite a different set of problems is presented by compulsory arbitration; that is, by tribunals to which the contending employers and employees must submit their differences, and by whose decisions they must abide. Such is the system now in use in Australia. Its essence is that judicial tribunals

are constituted, to which application for the settlement of disputes may be made by either party. The terms fixed by the tribunal become binding on both, and failure to carry on work under these terms becomes a criminal offense. A strike or lockout is punishable by fine or imprisonment.[1] The tribunal may consist solely of a person or persons legally trained (say a judge of the established courts of law), or may have in addition persons conversant with the particular industries. Obviously, workmen can appear before such a court only as organizations or unions; for not individual complaints are to be settled, but disputes applicable to all. Obviously, also, these organizations must be open unions, and the statutes or the courts must make provision for their being open. It is hardly less essential that the employers should be organized, since for them also there are to be rates and rules of general application. The system thus involves a court, powers of coercion by that court, and the organization both of employers and employees as parties to proceedings before it.

The settlement of wages under such a system is likely to be comparatively easy at the outset. The adjudicated rates of wages are likely to be, when first fixed, somewhat higher than those previously current; but still "fair," and not higher to such an extent as to present a real question of principle. There is usually a certain amount of slack in industrial arrangements which can be taken up without serious strain. But as time goes on, the workmen and the community in general will again become accustomed to the new scale. The workmen, it is almost certain, will before long ask for more, and then for more and still more; until finally the tribunal will be compelled to consider how far it can go in modifying the terms of

[1] In New Zealand, where the first compulsory arbitration law was passed (in 1896), a strike or lockout becomes a criminal offense only if one of the parties has made application to the arbitration court. "If both parties prefer to settle their difficulties by a strike, the law permits them to do this." In the New South Wales law (1901), however, every strike or lockout, prior to or pending consideration by the court, is a misdemeanor and punishable as such. In other words, in New South Wales, all disputes *must* be referred to the arbitration court. See V. Clark, *The Labor Movement in Australia*, pp. 189, 191.

distribution. Where stop? What are "fair" wages? That question cannot be settled without settling what is fair interest and fair business profits. Ultimately, the tribunal must determine what is fundamentally just; how much the owners of wealth are justly entitled to in the way of interest; what is a "just" return to the employer in the way of business profits; why some laborers are to receive more than others, and what is just as between the different groups.

In other words, this sort of labor legislation involves a very different attitude toward competition from that which underlies factory legislation, regulation of hours, children's work, minimum wages. These aim to modify the plane of competition. They prohibit some sorts of labor bargains, or impose upon all employers requirements as to safety, cleanliness, health. But compulsory arbitration does not content itself with defining the limits within which competition shall work. It supplants competition. Wages, interest, profits, are not to be determined by the bargaining of employers and employees, with liberty for each party to desist at will and see how the other can get on without. They are to be fixed by public authority; and this involves settlement by public authority of the distribution of wealth.

This ultimate problem may be disguised and postponed. It is even conceivable that it will be postponed indefinitely. The force of custom is enormously strong. Possibly the workmen will never push their demands so far as to raise the question of the ultimate limit. They may content themselves with such minor changes as are constantly taking place under the influence of general economic causes, and are disposed of with substantially the same results by voluntary arbitration and trade union activity. Such has been hitherto, in the brief period during which it has been on trial, the working of compulsory arbitration in Australia. But with the increasing political power of the laborers, their quick habituation to any higher scale of wages, and their recurring demands for wages still higher, it is probable that the fundamental problem will sooner or later have to be faced, and somehow solved.

What the outcome then might be, it would be rash to predict. Indefinite increase of *all* wages means a cutting down of the returns to investors and business men, and — so we should argue on the basis of our general theorizing on distribution — an eventual check to accumulation and to business enterprise. This may lead to an early reaction, and to a reduction of wages once more to rates consistent with the present mode of conducting industry. Or it may lead (and this is equally possible) to still further radical changes, — a steady assumption of many sorts of business management by the state, and the appropriation or purchase by the state of the capital now owned by investors and managed by business men. In other words, it may lead to a trial of socialism, which puts into effect without disguise the same principle, — the settlement of distribution by the state. Few people see that the scheme for compulsory arbitration points to changes so far-reaching. Nothing of the sort was contemplated when it was established in New Zealand and the other Australian colonies, and, though it has already become apparent that much more is involved than a device for merely patching up industrial disputes, the full possibilities do not yet loom up before the Australians. The course of their experiment will be watched with interest by all students of social and economic problems; both to see whether the temper of the workmen will lead them to press their demands to the limit, and what may be the consequences if they do. Many years will probably elapse before this remarkable experiment will have been carried so far as to make clear the ultimate outcome.

During the intermediate stage, when no very radical changes are attempted. — a stage which, as has just been said, may be prolonged indefinitely, — one other difficulty is more than likely to appear: how to enforce the arbitration decisions when they prove to be against the workman. Enforcement against the employers is easy enough. They have property, usually ample and visible, and they can be brought to book by fines. But against employees fines must remain a merely nominal

mode of enforcement. Quite apart from the expense of collecting driblets of fines from scattered workmen, the political odium of the proceeding will prevent any democratic government from pushing it far. Experience of this kind — that compulsory arbitration works in effect one way only — may possibly lead to a radical change in the whole system before it is carried to the stage of bringing the fundamentals of distribution to a test.

§ 7. Compulsory arbitration may be applied, however, not to all industries, but to certain industries only, selected because in them continuity of operation is of special importance to the public. Such are many of the so-called public service industries, — railways and street railways, telegraphs and telephones, gas works, electric works, and the like. It is intolerable that the means of everyday communication should be suddenly brought to a standstill, or the supply of artificial light suddenly cut off, because the employers and employees cannot come to terms. Nothing is more significant of the easy-going good nature of the American people than their submission in patience to repeated "tie-ups" of this kind. In England, concerted cessation of work in these industries, without reasonable notice given, has been made punishable by the criminal law, — a mode of dealing with the situation which is probably of no great practical effect (since the enforcement of the criminal law against the strikers is difficult), but one which at least registers a strong public opinion. In this country the proposal has been made to compel resort to arbitration in such cases, and thus prevent the spasmodic interruption of great public services.

Compulsory arbitration of this sort clearly would not have to face the problems which underlie general compulsory arbitration. The standards of wages accepted as right for the particular industries would be those which obtained in similar occupations not subjected to arbitration. Just as a partial extension of public ownership, to railways, telephones, and other selected industries does not compel the public managers to settle principles of distribution of their own, and therein is

essentially different from socialism,[1] so a partial application of compulsory arbitration does not put the public authority in the position of setting up any general standards of justice for wages and profits.

The serious difficulty would be that of securing enforcement of the decisions. Here, as in the case of general arbitration, enforcement against the employers is feasible; but not so as against the employees. In practise, the real efficacy of such "compulsory" arbitration, so far as the workmen are concerned, will lie in the state of public opinion. Hence it will serve in reality, not as a method of compulsion, but as one of conciliation. Yet it may none the less be of great usefulness. It serves to focus public opinion, and so to bring a powerful force to bear in favor of peaceful settlement. Thus, in the United States, boards of mediation and conciliation were established in 1898, and put on a more permanent footing in 1913,[2] to act as mediators, and to arrange for arbitration, as to railways; an authority which has been used with success in not a few cases of threatened struggle.

It is somewhat curious that both in England and in the United States the trade-unionists have been opposed to schemes for compulsory arbitration, whether of general or of partial application. They prefer their liberty of striking and fighting. This state of feeling is probably due in the main to the belief that the control of public affairs is in the hands of the property-owning class, and that the workmen would virtually be subject to compulsion from their opponents. In the United States, moreover, the feeling is strengthened by the spirit of lawlessness which still so largely infects the trade-union movement, and which is shown also by their hatred of the soldiery. The truth is that the workmen are not fairly conscious of the power which they possess in a democratic community. They are hedged in by all the customs and conventions of the existing

[1] See below, Chapter 64, § 4.

[2] The act of 1913 created a formal Board of Mediation and Conciliation, consisting of a permanent Commissioner and two other officials designated by the President.

order, and are not aware of their ability — would they but exercise it — to burst these bonds. Hence they prefer measures which strengthen their position in the industrial system as it stands, to measures that look to any fundamental changes in that system. Like the business men with whom they negotiate, they rarely look far into the future. Except for the few who are touched by the socialist gospel, — and but few are really touched by it, though many use the phrases, — they think only of immediate results within the traditional framework of society.

CHAPTER 58

Workmen's Insurance. Poor Laws

§ 1. Irregularity of earnings is a much more frequent cause of distress than are earnings absolutely small. Men accommodate themselves to almost any income not below the bare minimum. But few men provide adequately for vicissitudes. Where the margin between receipts and necessary expenditures is slight, any interruption of income means suffering. Even when the earnings are such as to make possible a sufficient provision, by savings or insurance, the provision is not often made. How to mitigate the consequent suffering among the great mass of the population is one of the most urgent of social problems. It is a problem, too, to which more and more attention has been given in recent times. This increase of attention has not been due to greater irregularity in earnings, or greater need of provision for contingencies. I know of no satisfactory evidence to show whether the chances of illness uncared for, of disabling accident, penniless old age, are greater now than in former times. But the modern world is clearly more sensitive to the evils. Here, as elsewhere, conditions accepted in former days as matters of course are now regarded as intolerable, and a strenuous effort is made to remedy them.

Accident, sickness, old age, unemployment,—these are the main causes of irregularity in earnings. As to all, it will be necessary to keep in mind a large question of principle: how far can aid be provided without undermining the character and thrift of the individual?

§ 2. Provision against accident should be arranged through insurance. The only question can be as to the best way of making the insurance effective. By far the most important class of accidents, though not the only important one, is that of

accidents to workmen occurring in the course of their employment. Such will infallibly occur; and it is equally certain that no effective provision will be made against them by the workmen themselves. It is even doubtful whether that sort of rough provision is made which would appear in a higher rate of pay in hazardous employments. The risks of injury in an employment are accepted by almost all workmen with virtually no attention or allowance; and when, sooner or later, the inevitable disaster occurs, they or their dependents are left helpless.

The chance of accident varies in different occupations. It is sufficiently well ascertained in most occupations to be susceptible of insurance, both as to accidents having fatal result and as to those bringing permanent or temporary disability. When once the possibility of dealing with them on actuarial principles is clear; when it is certain that the workmen themselves will not insure; and when the sense of social sympathy and duty becomes so strong that provision of some sort is insisted on, — the only solution is to make the employers responsible. Let them do the insuring, paying premiums from time to time which will enable a death benefit or pension to be paid to widows and orphans, or a pension to the disabled workmen themselves. The premiums required, if paid uniformly by all employers, will enter into the expenses of production of all — more heavily, of course, for those whose trade entails the largest risks — and will affect in varying degrees the prices of the commodities sold. Such a plan will have far-reaching effect only if it is made of compulsory and universal application, and if the mere fact of employment fixes the obligation of the employer, irrespective of any agreement between him and the employee.

The desired result of assured provision can be secured either by requiring the employers to organize directly in insurance associations of their own, or by simply imposing on them a liability against which they can insure in companies existing for this purpose. Of the former type of procedure, Germany

supplied the earliest and most conspicuous example; of the latter, Great Britain. The German system, established (1884) as the first part of the Empire's elaborated system of workmen's insurance,[1] compels the employers in each trade to form a sort of insurance company carefully supervised by the government, to contribute premiums adjusted to the risk of accident, and thereby to enable the payment of pensions to disabled workmen (at the rate of two thirds their former wages for those completely disabled) and corresponding pensions to widows and minor children. The British Workmen's Compensation Act (1897), on the other hand, simply provides that the employer must pay a pension (of one half the former wages, but not exceeding £1 a week) in case of disability, and in case of death a lump sum amounting to three years' wages, with a minimum of £150 and a maximum of £300. In what manner he shall make the provision is left to his own discretion. In practise he almost always insures in an employers' liability company; very few employers carry on their operations on so large a scale and with such continuity as to make it safe to insure themselves. Substantially on the same principle is the French system (established 1898) where the pension in case of total disability is two thirds of the wages rate, and where also the design and the effect is to compel employers to carry insurance against their unqualified liability. The German method is natural in a country where the public administrative system is developed to high efficiency, and where detailed supervision by government authority is helpful and not unwelcome. The English and French methods are adapted to communities whose traditions and habits are against such far-reaching government regulation. Each makes certain, though not in the same way or quite to the same extent, provision against accidents occurring in the course of employment.[2]

[1] This system forms a consistent whole, and might be described as a whole; but the different parts are here taken up separately, according as they involve different phases of the problem.

[2] It should be noted that the English statute gives the workman an option between proceeding under the Compensation Act and suing the employer for his

No objection of principle can be raised against such a system. Injuries from accident cannot be shammed, nor will they be incurred of set purpose. No doubt they will be incurred through negligence. But the negligence is not made greater by the assurance of provision. It remains the same, unfortunately, whether the workman knows or does not know that he will be taken care of if anything happens. Negligence can be offset effectively only by introducing safety appliances, by guarding machinery, by stringent discipline, — precautions which the employer is stimulated to adopt when he is certain that the amount of his premiums will be lessened by them. In the legislation both of Germany and of Great Britain it is enacted that a workman who intentionally brings an injury on himself shall have no claim; but this sort of contingency may be disregarded. There is no inducement to malingering or improvidence because of provision against accident. The humane impulse hence need not be held in check by a fear that the immediate relief of suffering will be followed by subsequent demoralization of the sufferer.

Who ultimately bears the charges which under such a system are first imposed on the employers? It is sometimes reasoned that they will fall on consumers. Employers, no doubt, will bear them at first, as they would bear a tax (and indeed compulsory payments of this sort are difficult to distinguish from taxes). But in the end the charges are expected to influence prices, as will any other additions to the expenses of production. Hence it is argued they will be borne finally by consumers. But, obviously, this sort of reasoning needs to be qualified as much as similar reasoning applied to taxes.[1] It is true that a tax on any one commodity raises its price, and affects the consumers, not the capitalist producers or employers. But a tax on all commodities cannot raise all prices. So far as

liability under the law as it stood before. But the trend is for less and less recourse to the latter method, and more and more resort to the Compensation Act; and it is probable that resort to employers' liability of the old sort will eventually disappear.

[1] Compare what is said below, Book VIII, Chapter 70, on the incidence of taxes.

insurance premiums bear more heavily on one industry than on another, they will have an effect, under competitive conditions, on relative prices, and so will be felt by the consumers of those things made in the hazardous industries. But so far as they affect all industries alike, prices will not be affected. Employers must bear the charge once for all, subject to only one avenue of escape, — they may lower wages, directly or indirectly, immediately or ultimately. Direct and immediate reductions of wages are highly improbable. Here, as in other similar situations, there is likely to be enough slack in the adjustment of wages and profits to enable some tightening, some drain on profits, without any immediate effect on wages. But when such a system is in steady operation, and has been for some time in operation, every employer knows that the act of employment involves not only wages, but these additional charges also. His calculations must be correspondingly affected. The outcome is likely to be that the insurance charges will ultimately come out of the workmen's own earnings. This will take place, not necessarily by any process of direct reductions in wages, but more probably, in progressive countries like Germany and England, by a failure of wages to advance as much as they would otherwise do. Obviously it is no objection to an insurance system that the premiums ultimately come from the beneficiaries themselves.

In case of industries having a monopoly or quasi-monopoly, shifting of the charges is much less likely to take place. · industries will indeed share with others any general effects ll wages. But so far as they are subject to special charges, will probably bear the charges once for all, just as they e obably bear special taxes once for all. Railway operag r example, brings great risks for the trainmen, and rails, hould be called on to pay comparatively high insurance hiums. These, unless extremely heavy, are not likely to be I to the public in higher fares or freight rates; they cone a definitive burden for the employers, whether private

Employers on a large scale accommodate themselves most easily to a compulsory insurance system. They have large resources, allow a good margin for contingencies of all sorts, commonly lay their plans with reference to considerable periods. Smaller employers are less able to adjust themselves to additional expenses. Hence the rigorous application of any form of labor legislation, whether in the way of restriction or of compulsory expense, tends to hasten the development of large-scale production; a result which, no doubt, is in accord with the general trend of modern industry, yet is not welcome to most persons who have at heart plans of this kind for social reform.

A considerable proportion of mishaps are not provided for by insurance *via* the employers. Accidents to independent artisans, to those in the service of petty employers exempted from the general system, most of all accidents not occurring in the course of working operations, are not included. It is possible and desirable to give an opportunity in some of these cases (to independent artisans, for example) to join of their own volition the insurance system; but unfortunately this opportunity is likely to be availed of only in a small proportion of cases. A large place is still left for private charity and public poor relief.

§ 3. Insurance against sickness is as feasible as insurance against accident. It is even more feasible, since longer observation has supplied more adequate data as to the frequency of illness in great modern communities, and as to its greater frequency with advancing age; while the progressive gain ways of healthful living has introduced a factor of safety whi is not found in accident insurance.

Saving against a rainy day — a rough sort of insuran against illness as well as other mishaps — is common amo the well-to-do and the lower middle class. In the latter cla and among the skilled artisans, there has been a considera development of insurance proper. The Friendly Societies Great Britain — the Odd Fellows, the Foresters, and of important associations — have carried on insurance agains

ness on a large scale. Branches or outgrowths from them, and imitations of them, have done the same thing in the United States; and there are some associations of this type in most countries. They provide commonly against disability of all sorts, whether the result of illness or of accident. The same is done by the British trade-unions, among whom the benefit system has an established and important part, including sick pay as well as trade benefits (strike pay and the like). It is true that the premiums or dues of all these organizations are commonly inadequate. They promise more for a given weekly premium than they are able in the long run to furnish. Like the "fraternal" life insurance organizations which have had, and still have, such a vogue in the United States, they undertake to pay amounts greater than their dues warrant them in undertaking on sound actuarial principles. None the less, and notwithstanding frequent collapses, they have done great service in mitigating the hardships from illness and consequent loss of earnings. Their serious and irremediable defect is that they reach only a class comparatively prosperous, — tradesmen, persons on steady salaries, skilled artisans.

It is this failure to reach the great masses of the people that led the German statesmen to adopt the compulsory (and therefore universal) system for sick insurance as well as for other forms. No other method will bring relief with certainty to those needing it most. The German law of 1883, the first in time of this great series of measures, established associations, commonly organized by locality (one for each town or rural district), in which all workmen are insured against sickness. Contributions are payable by employers, whose obligation to pay is fixed by the act of employment; but they may deduct two thirds of the amounts from the stipulated wages (the remaining third being a charge on the employer himself). The workman gets, while ill, one half his usual wages, and in addition free medical treatment; in case of need, hospital treatment.[1]

[1] Cases of injury from accident are treated in the German system as of illness during the first twenty-six weeks (one half of a year). Only if dis-

The ramifications and details of the system are carefully worked out; they call for an enormous and skillfully developed organization; they secure, for practically every person employed at wages, a sufficient provision in case of illness.

The question of principle presents itself somewhat differently in this case. Illness may be shammed; malingering is a clear possibility. For many a laborer half pay and no work make an attractive combination. The administration of any system of sick insurance hence calls for watchfulness. The Friendly Society, whose local lodge is made up of a comparatively small number of persons known to each other, can supervise its benefits without cumbersome machinery and yet with sufficient checks. A visit from a committee of members attests sympathy, and at the same time secures an inspection of the invalid. The system, though not without opportunity for fraud, yet has a quasi-automatic safeguard against malingering. The same is the situation where trade-unions provide sick benefits. But a great compulsory system, in which thousands of persons (as in a city) are insured against sickness, calls for the most watchful management, — physicians' visits and reports, elaborate records, systematic supervision, more or less of red tape. If badly administered, it is likely to become demoralizing to the recipients of aid, and in the end more harmful to them than complete indifference and abstention from aid.

It is to be said that no such evil consequences have appeared on any large scale in the German system. True, there has been malingering, and measures to stem it have had to be considered. But on the whole these drawbacks have been no greater than was inevitable; and the social gain has vastly exceeded the loss. The administration of the German sick insurance system, and indeed of the whole system of workmen's insurance, has been in high degree efficient. Substantial aid to the afflicted

ability from accident endures beyond twenty-six weeks, that is, in case of long-continued and presumably permanent disability, does the machinery of accident insurance begin to apply.

has been combined with safeguards, adequate on the whole, against fraud. Hardly another country possesses the staff of trained public servants needed for planning and administering so vast a machinery for social reform; and the Germans are justly proud of what they have here achieved.

§ 4. Old age is a contingency in this sense, that no one knows whether he will reach it. Provision for old age can be made by insurance, and is so made, to some degree, by the well-to-do through insurance companies. But even among the well-to-do, it is not often made systematically. In the social tier below that of the well-to-do, friendly societies and trade-unions sometimes have a system of superannuation benefits; but it is effective only for an insignificant proportion of their constituency. Among the masses of the population there is commonly no set provision of any sort for old age; and when infirmity comes, the aged are dependent on the younger generation or on charity. There is nothing more pathetic than the position of the workman, skilled or unskilled, who has passed the age of efficiency, has no resources, and is a burden, often borne grudgingly, on a household with slender resources.

Old-age pensions are now provided by public authority in sundry countries. The great German system includes them, and applies to them rigorously the principle of insurance. Employers there pay the premiums, with the same arrangement as in sick insurance for deducting from wages part of what they advance. One half of the premiums can be so deducted, the other half remaining as a charge on the employers; while a fixed sum (of 50 marks annually) is contributed toward each pension by the Empire, that is, by the taxpayers. The amount of the premiums due for each workman, and the pension payable to him, vary according to his wages. This system requires an enormous amount of bookkeeping, an enormous investment of accumulating funds, and very expensive administration. Probably it is unnecessarily cumbrous. Much simpler is the plan of giving to every workman or to every needy workman, once for all, from public funds, a pension on reaching a given

age limit. This is what is done in the English-speaking countries which have established old-age pensions, — in Great Britain herself, and in Australia and New Zealand. In all of these, to be sure, the pension is subject to reduction according to the applicant's need. Only those having no other income, or but a slender income, are pensionable; and in the Australian states there is a restriction also for those who have some accumulated means.[1]

Old age cannot be shammed; so far, an old age-pension can lead to no demoralization. But it is maintained that it will discourage thrift, since it takes away the incentive to make independent provision. Unfortunately, there is in fact no appreciable amount of thrift to be discouraged, least of all among the great mass of manual workers. They exercise no thrift and make no provision, and they are not likely to do so. Some small accumulation of capital funds there may be on their part; and it is probably unwise to make such accumulation a bar to a pension, or a ground for reducing the amount of the pension, as is done in the Australian states. The British regulations are in this regard better, in that they make the possession of an income alone (not that of a principal sum) a ground

[1] The maximum pension obtainable in Germany is 415 marks a year. The British pension (available for women as well as men) is, under the act of 1908, 5 shillings per week for those whose income from other sources does not exceed 10 shillings a week; it diminishes as other income increases. The maximum pension in New Zealand is £26 per year; that in New South Wales was £26 per year, in Victoria 8 shillings a week. Virtually the same rates have been maintained in the old-age pension system established for the Australian Commonwealth in 1909. The age at which the right to a pension accrues is 70 in Germany and Great Britain, 65 in Australasia.

Under the British system, as adopted in 1908, no pension is payable to a person having an income of £31½ a year, and the pension is subject to progressive reduction where incomes are between £26 and £31½. Those whose incomes from other sources are £26 or less receive the full pension of 5 shillings, whether the income be from invested funds, annuities, friendly society benefits, or other source.

It should be noted that the German pensions are paid not only in case of old age, but in case of permanent infirmity also. The number of the infirm to whom pensions are paid has proved to be — apparently contrary to expectation — much in excess of the number of the aged. The same questions of principle arise concerning both sorts of aid, with only the difference that fraud needs to be guarded against more carefully in cases of alleged infirmity.

for reducing or refusing a pension. The German plan, being one of insurance strictly, pays no attention to any income or property which the claimant may have. He gets his pension as matter of right, in virtue of the premiums paid on his account through the preceding years; and anything he has done for himself, in the way of savings, inures to his benefit without diminution of the pension. But, to repeat, voluntary provision for old age is a negligible element. If there were such, it might be discouraged by old-age pensions; but virtually there is none.

It is a fair question whether the state does not do as much as may be in the long run expedient, by simply providing opportunities for old-age insurance. Such was the policy long followed by France, though superseded very lately (1910) by a compulsory system similar to that of Germany. The French government long maintained a public "caisse des retraites" in which any one might insure, and to whose pensions the government itself added one third by way of subsidy. The state of Massachusetts has recently (1908) enacted legislation by which the savings banks may provide old-age insurance under public supervision. Whether all that may be expected of the state is thus to furnish facilities cannot be settled by any simple formula. The answer must depend largely, also, on one's hopes as to the future of workingmen under the régime of private property. There are those who look forward to a steady improvement in the welfare of the masses, and to a growth of intelligent forethought among them. Such persons believe that the old-age problem will take care of itself; partly because provision will be made by thrift, partly because children will be better able to support their aged parents. But the outlook, whether for foresight or for much ampler means, is certainly unpromising for the visible future. The French voluntary system, though in operation for half a century, accomplished virtually nothing, so far as it was really voluntary. The only persons whom it reached were public employees, and workmen insured *en bloc* by some private employers.

Those who favor universal old-age pensions are influenced not only by the growing strength of altruism, but by the belief that such aid does not really discourage thrift or independence. It meets a need which all know to be inevitable, but which few provide for until it is nearly on them. Old-age pensions are familiar for some persons of the comparatively well-to-do classes, such as teachers and public officials. These pensions are not found to discourage thrift or undermine character, and they prevent much anxiety and suffering. Why should there not be a similar balance of good in the case of aged workmen?

Obviously, a system of old-age pensions must entail a very heavy financial burden. Where the provision is made once for all by the state, the needed sums must be got by taxation; and the difficulty of getting the money is often regarded as an insuperable obstacle. But, as in all other matters of public expenditure, the question here is not whether the community *can* raise the revenue, but whether it really wishes to. Old-age pensions in Great Britain were long opposed as financially impossible. Yet Great Britain, when her people's blood was up for the South African war, taxed herself without hesitation for sums much greater than any old-age pensions could require. When the plunge to a pension system was finally made, the needed money, though grudged, was not impossible to provide. If the impulse of sympathy were as strong as the ancient and brutal fighting instinct, we should hear little of financial obstacles in the way of schemes for far-reaching social improvement.

§ 5. In the United States the whole movement for workingmen's insurance or pensions long made slow headway. The situation is in striking contrast with that in the other civilized countries, great and small. Elsewhere there is unceasing discussion of the ways of relief by public action, and steady progress in legislation. In this country we are as backward as in many other matters of social reform. We are wont to flatter ourselves that our condition is a superior one, and that we are not confronted with the same social and industrial evils as older

countries. But the superiority is only one of degree, and no longer a great one at that. The need for amelioration is hardly less.

So far as provision for accident goes, our case long was wretched. There was supposed to be a liability on the employers for injuries occurring to workmen in the course of their employment. But the liability was so hedged in by sundry legal limitations (varying according to the judicial decisions and the statutes of the several states), and so beset with uncertainties, that it brought a provision only in a small minority of cases. Most cases were settled out of court by a compromise between the parties, with outcomes varying according to the helplessness of the victim and the astuteness of employers' counsel. Where cases got into court, the question whether the workman should get compensation depended on the lottery (such it virtually was) of a suit at law and a trial by jury. The lottery occasionally brought a prize to an injured laborer, in the shape of a heavy lump sum in damages. This sort of prize blinds the workmen at large to the immensely greater number of cases in which nothing is got. They overestimate the prize, just as they underestimate the chance of injury in dangerous occupations. In its general outcome, the situation illustrated strikingly the possibilities of waste in the individualistic system. Most of the energy of those engaged in the disposal of accident cases — judges, jurymen, lawyers, casualty managers — was simply unproductive of social gain.

This situation was so obviously bad, and the example of other countries pointed so clearly to the remedy, that a great change set in during the second decade of the present century. State after state in rapid succession enacted workmen's compensation laws. Constitutional provisions in some jurisdictions imposed limitations and obstacles, and in particular stood in the way of an absolute and unconditional requirement of compensation. Among the forces that stood in the way of uniform and unconditional provision there was also the clinging by the workmen themselves to the option for suing their employers for damages, with its delusive possibility of a heavy

jury award. Different systems were adopted in different states; and not infrequently the compensation was inadequate as well as lacking in certainty. Usually the same method was followed as in Great Britain and France: the burden of compensating the workmen was put on the employer once for all, but some freedom was left him as regards the manner in which the provision should be made. In many jurisdictions he was given an option of insuring either in a private employers' liability company or in a coöperative ("mutual") insurance company controlled by the state and competing with the private companies. But there were instances (as in California) of an all-inclusive compulsory organization managed directly by the state. The rapid spread of the reform is significant: it shows how, even in a conservatively-minded community like ours, a gathering and cumulative public opinion brings about, when once a first step sets the example, the rapid adoption of measures long deemed impracticable. It is not to be doubted that in time, and probably in short time, every part of the country will have provided at least passably for this important social advance.

The other phases of workmen's insurance present more complex problems. Old age pensions, on a non-contributary basis, come next to provision against accident in ease and simplicity. But if put on a contributary basis, — which in principle is preferable, — they involve the collection of premiums over many years, the investment of large funds, elaborate records, provisions for cases of changed domicile and occupation. The administrative problems are highly complex in the case of sick insurance also. A compulsory and universal system, with its need of registration, of elaborate checks, of medical attendance and supervision, presumably of contributions from employees, can be set up only by well-devised legislation, and can be effective only under administration at once stringent and humane. In the field of social reform, as in so many others, these difficulties are especially serious in the United States The national government is limited in its constitutional power. The states can never act in unison, and are often deterred from

proceeding separately by mutual fears and jealousies. Their large and cumbrous legislatures, elected for short terms, do not easily frame careful and consistent laws. The absence of permanent tenure in the upper administrative service causes a lack of trained officials. All this will doubtless change gradually for the better, and the conditions will become more favorable for the assumption by the state of larger and more difficult undertakings. Among such is a far-reaching system of provision against sickness and old age; concerning whose future in this country it would be hazardous to predict more than that in some form it is tolerably certain to come sooner or later.

§ 6. Unemployment presents problems even more difficult than accident, old age, and sickness.

Socialists like Marx and Rodbertus contend that a large reserve of unemployed workmen necessarily comes into being under the capitalist system. In answer, it may be maintained that a steady supply of unemployed laborers tends to bring its own remedies; it brings a competition for places, a bidding of laborers against laborers, a readjustment of terms between employers and employees, and the final attainment of a stage of equilibrium when all will be absorbed in industry. As a matter of abstract reasoning, this is more consistent and logical than the socialist attempt to prove that continuous unemployment on a large scale is inevitable. To put an extreme case, if one half or one quarter of the total number of laborers were long unemployed, it is certain that readjustment would take place, by lowered wages and probably altered industrial arrangements; and before long there would be diminution of unemployment, and eventually (supposing the process to work out its results without check to the end) none would be left.

But all reasoning that attempts to show how unemployment tends to bring its own remedy assumes settled conditions of industry, — the absence of friction and transition and irregularity. Such conditions never exist in the actual world, and never will exist, unless indeed under a rigid socialist régime. An automatic adjustment of the supply of labor to those conditions under

which all shall be employed, works out in fact only as a rough approximation or *tendency;* like the tendency of imports to balance exports, of prices to conform to the quantity of money, of the earnings of individuals to be in proportion to their efficiency. In the actual world there is but a loose conformity to these long-run tendencies. So far as unemployment goes, though it is true that, the greater its extent, the stronger are the forces which tend to make it diminish, there are abundant causes for its being a continuing phenomenon. The steady progress of invention and improvement brings shifts in the employment of labor; at any given moment a certain proportion of men are being displaced in one industry and are not yet absorbed in another. The restlessness of the workmen themselves — promoted as it is by the monotony of factory work — is another cause of shifting. The periodic maladjustments of industry and the recurrence of stages of depression are a great and calamitous cause of unemployment. Similar in effect, and more continuously in operation, are the seasonal oscillations. These are sometimes inevitable, as in the work of the harvests. Often they are not inevitable, but due to the mere crudeness of our organization of production and exchange. In such industries as the making of boots and shoes, clothing, straw hats, and the like, there is no inherent reason why the work should not be evenly distributed through the year; but in fact busy seasons are followed by slack, and overtime work by unemployment. Casual and irregular labor is sometimes inevitable, as in loading and unloading freight from vessels and railways; and it is frequent even where not inevitable, because many employers are disposed to utilize casual labor rather than take the trouble of arranging for a permanent staff. So constantly are these various causes at work that nonemployment is an unceasingly recurring phenomenon, and in that sense a permanent one.

Any method of insurance for equalizing the irregularities, presents some obvious difficulties of administration. The irregularities are of a sort which do not clearly offset each other

in the long run, like the chances of death and old age. They are therefore susceptible of actuarial treatment only with a very wide margin of "loading." That they vary from occupation to occupation is not so serious a difficulty. Insurance against unemployment would doubtless have to be organized, like insurance against accident, on the basis of occupations, and with differences of rates according to the varying risk of unemployment.

All such difficulties, however, are slight in comparison with the fundamental one: how prevent an unemployment benefit from demoralizing the recipient? If all men were eager in the search for work, relief in case of unemployment, whether by insurance or any other method, would be a comparatively simple matter. But for most men, assured support until a job is found makes it too probable that the job will not be sought.

One method of insurance that has had some promising results is through trade-unions. The strong British unions offer an out-of-work benefit (not to be confounded with their strike benefit) which has been administered successfully and beneficently for many years. It is conducted under conditions that go far to prevent abuse. The officers and other members of the local union know what is the state of trade in their district, what are the possibilities of employment, what the spirit and habits of the recipient. They are watchful against fraud upon the union funds. They can not only give out-of-work pay, but make sure that all available opportunities for getting work are utilized, and that benefits continue to be paid only so long as unemployment is inevitable. This mode of coping with the problems has seemed so promising that experiments have been made toward utilizing it in the assignment of unemployed benefit by public authority. A number of cities in Belgium and elsewhere have adopted the "Ghent system" (first developed in that place with apparent success) of offering a supplement to the trade-union unemployed benefit; they pay say 1 franc for every 1½ francs allowed by the union.

With this enormously difficult problem Great Britain grappled courageously, almost adventurously, in her insurance act of 1911. That great measure provided not only for an all-embracing system of insurance against sickness and permanent infirmity, but also for a large though not universal one against unemployment. Thereby Great Britain came to provide, like Germany, for sickness and disability, as well as for accident and old age; and in this humane rivalry took the lead by providing for unemployment also. In certain important occupations (such, for example, as building, the so-called engineering trades, shipbuilding) insurance against being out of work was made compulsory. Contributions were required in equal amounts from employers and employees, the state also adding a share. A system of labor exchanges was established for facilitating the mobility of labor and thus checking unemployment. Like the German insurance code, this was a remarkable piece of legislative workmanship; while its chance of successful operation was immensely increased, as had been the case in Germany, by the existence of a trained permanent administrative staff, to which could be allowed much discretion on details. An extraordinary forward step was taken in this field of social reform.

Public relief works are a tempting device. Yet they have proved of service chiefly as safeguards against imposture; and for the latter purpose they are of uncertain effect,—they sometimes cause imposture. It is remarkable testimony to the general effectiveness of the régime of private industry and to the extreme difficulty of finding a substitute for the spur of pecuniary interest, that relief works have rarely been successful in putting any considerable number of deserving unemployed at work on something really worth while, and have never been successful in achieving this result for all the deserving unemployed. It is easy to declare that, at a given juncture, there are both unemployed laborers, and needs to be satisfied for the community by the labor of somebody. To bring these two together, and set the men to work on things they can do and on which their labor tells to full advantage, is the most difficult task a public

official can be confronted with. The work is almost always felt, by the public employer and by the aided employee, to be perfunctory. Only where the simplest and most monotonous of tasks can be assigned, — as wood sawing or stone breaking, — is it possible to provide work for the unemployed and to hold them to a fixed stint. Very little work of real utility can be laid out in this mechanical way. Most things worth doing are more complex. It is difficult at best to find work that is thoroughly worth doing; it is even more difficult to get it efficiently done by relief operations. For one thing, the power of discharge is lacking; and it must be sorrowfully admitted that this power, heartless though it seems, and subject to abuse as it is, remains essential for keeping the ordinary laborer steadily at his task.

None the less, public works of a kind that are certain to be carried out sooner or later, may best be set going in times when there is special lack of employment. Some palliation for the recurring stages of depression may be found by massing in such periods settled public expenditures. In a country like Great Britain, for example, the great industry of shipbuilding is specially subject to those fluctuations which, as we have seen, are marked in the industries that make plant and machinery.[1] If the government must build men-of-war, let it put the shipyards to work on them in those times of depression when the demand for merchant shipping is at a standstill. Similarly, a country in which railways are publicly managed may arrange for new construction and extension at times when private investment is halting. This calls for a firm hand in checking the public expenditure as soon as private undertakings revive. Many people, employers and employees, will be certain to clamor for indefinite continuance. Even when prudently managed, this is but an uncertain device, subject to the dangers of perfunctory public works. Nevertheless, it is better than the common procedure of letting the rush of speculative activity reach public operations also, thus exaggerating both the upward swing and the subsequent recoil.

[1] See Book III, Chapter 29, § 2.

Arrangements for spreading information and increasing the mobility of laborers are good without qualification. Much more can probably be done in this way by public authority than has yet been accomplished. Private agencies are subject to great abuses. They find the laborer when he is least capable of holding out and bargaining, and when it is most easy to take advantage of his weakness and ignorance. Something, too, can probably be done in systematizing the distribution of seasonal and casual labor, — dock and railway labor, harvest hands, men engaged in construction work. Germany and England are now experimenting on a large scale with labor exchanges; and some of our states are also conducting public employment bureaus. Here, again, the social ferment is at work, and the problem is grappled with as never before. To achieve good results in bringing unemployed labor to the places where it is wanted, and to systematize casual labor, officials must be put in charge who are capable, well-trained, and high-minded. Such men are wanted in every direction where the sphere of public activity is enlarging; and the success of all work for social betterment, most of all perhaps of work for relieving the poor and unfortunate, depends on success in selecting and permanently retaining administrators of the right stamp.

§ 7. No phase of social endeavor illustrates more clearly the conflict between sympathy and sober judgment than the poor law. Some provision for the relief of the indigent there will always have to be. The altruistic impulse will not permit the very last stage of misery to be reached. The various schemes considered in the preceding paragraphs, even though carried to their fullest possibilities, will yet leave untouched cases of misfortune, improvidence, wreckage. There will always be some occasion for simple charity; and charity always runs the danger of demoralizing the recipient.

Some sorts of relief can be given without danger of harming character. The pauper insane were formerly cared for in local almshouses, often under wretched conditions. The better

way is to take care of them with reasonable comfort in special asylums, administered not by local bodies, but by the central government, with skilled supervision. The feeble-minded, the blind, the crippled and deformed, those incurably ill, can be mercifully segregated in the same way, and with the same certainty that no one will be tempted to make himself an object for this sort of charity. It is doubtless true that much money and effort is devoted to these distressing cases which might be turned with better results to work, not of palliation, but of prevention. Schools are more effective agencies for upbuilding than hospitals. But the appeal for aid to the sick and wretched and maimed is not to be resisted; and it is at least to be said of hospitals and asylums that suffering can be relieved in them without sowing the seeds for still more suffering.

Something of the same sort can be said as regards the care of orphans and of neglected children. It is true that there is a Malthusian danger in the background: marriage and multiplication may be reckless if provision for offspring is assured. But the danger hardly exists so far as orphans are concerned, and is probably negligible even for the children of the worthless. The comparatively few whose children are cared for by public or private charity are hardly made more or less reckless by this provision; and the children themselves have a vastly better chance if put into proper hands at an early age. Their chance, it is true, is likely to be in any case a poor one. Commonly they have a poor physical and moral inheritance; and it is very difficult to secure for any considerable numbers good environment and good upbringing by strangers. But the children must be cared for, — they cannot be left to starve, — and good care may make them better men and women.

Old-age pensions, when they are really pensions and are restricted to persons in need, are virtually a form of poor relief. They simply go by the name of pensions, administered without the repellant apparatus of the poor laws. Whether they can be made respectable and even agreeable in this way with-

out undermining thrift, has already been considered. The balance of probability seems to be that here, as in the case of child saving, the altruistic impulse may be allowed its way.

The case is different with able-bodied adults. Poor laws, as regards these adults, are the most dangerous of well-meant devices. The certainty of support is the greatest enemy to vigor and independence. The history of the English poor law in the first third of the nineteenth century shows how an entire stratum of the population (in that case, more especially the agricultural laborers) can be demoralized by indiscriminate poor relief. While the only sure safeguard against pauperization is a general feeling of shame at becoming a recipient of relief, such a public opinion is itself largely the result of the proper administration of relief.

The English poor law investigators of 1832–1834, after surveying the experience of their country prior to the great reform of that date, came to the conclusion that the only safe way to administer poor relief for the able-bodied was to concentrate it in workhouses or almshouses. Outdoor relief (that is, relief outside the almshouse) was to be abolished. The principle was sound: let relief be made effective, but not attractive. For generations the abolition of outdoor aid was regarded by the English as the only feasible method of carrying out the principle. It was thought the *sine qua non* of successful poor law administration. But such relief, in fact, never disappeared in England, even for the able-bodied. Further experience and reflection have made it less certain that it ought to be completely done away with. The workhouse itself is often a school of demoralization, and relief in it, expected to be unattractive, ceases with habituation to be so. The keynote of modern charity administration is differentiation in the treatment of the various kinds of needy persons. Outdoor relief is admitted to be a highly dangerous remedy, better discarded entirely than used freely. Yet, with due caution, and especially as a means of tiding over temporary straits, it serves better than an inflexible almshouse test. Again, indoor relief, *i.e.*

institutional care, should be of various kinds, different for the young and the old, the sick and the well, the habitual vagrant and the workman temporarily in need. The complex problems of charity administration, themselves the subject of a large literature, are similar to those of workmen's insurance and the other phases of social reform. They show the widening influence of altruism and at the same time the search for rigorous and far-sighted method. Through all runs the same fundamental principle: aid the weak in such way as to strengthen them permanently.

CHAPTER 59

Coöperation

§ 1. Coöperation among manual laborers was long regarded as the most promising means of reaching better social conditions. The prospects of far-reaching change by this method seem less good now than they did to the economists of a generation ago. But the coöperative movement, none the less, remains an important one, not only because of its extent and its substantial results, but also because experience with cooperation is instructive as to the place of the business man and of business profits in modern industrial development.

The essence of cooperation is the getting rid of the managing employer. Laborers, or indeed any set of persons, whether laborers or not, do for themselves that work of planning and direction which is ordinarily done by the business man. They not only do his work, but they assume his risks. There must be in any case superintendence and administration; these are delegated partly to salaried agents, but are undertaken in part by committees or officers serving gratuitously. The coöperators as a body settle the general policy and assume the risks of the undertaking just as the stockholders do in a joint-stock company. In this last-named way, they aim to supplant the business man in his most important and characteristic function.

Coöperation has been tried in retail trade, in credit and banking operations, in some phases of agricultural work, and finally in "production." This enumeration proceeds roughly in the order of success: coöperation has been most successful in retail trade, least so in production. What has been the degree of success in these several directions, and what the explanation of the differences?

§ 2. Coöperation in retail trade, or distributive coöperation, is the simplest as well as the most successful form. A number of persons, workmen or others, get together, subscribe a fund, buy their commodities at wholesale, and distribute these among themselves. Simple as this is in outline, the business of retailing has its complexities. Goods must be on hand in convenient quantities, with due variety, easily found for the customer; those that become obsolete or shopworn must not be allowed to accumulate; the preferences and whims of purchasers must be humored. The coöperative stores have found that they must assume the outward appearance of the ordinary retail shop, with its show windows and placards, decorations and temptations. At one time in the history of distributive coöperation in England, it was thought possible to save rent by taking premises on a back street. But it has been found advisable to do as the private trader does, — take conspicuous premises on the main thoroughfares. Thus only can the purchasers be effectively reached, and shopkeeping conducted on a large scale and with real economy. Site rent, in other words, has been found to be not a cause of high price, but a result of efficient operation; and low rent has not been found to mean a real saving.

Where this sort of thing is done by persons of the well-to-do or middle class, it has no considerable social interest. As regards the larger questions of social reform, there is little difference whether a shopkeeper makes his profits or a body of coöperators save a bit by substituting for him salaried agents. This is all that is meant by such great coöperative stores as the London Army and Navy Stores, the Civil Service Supply Association, and others. These excellent institutions owe their success in large degree to their requirement of cash payments. The traditional relations between the ordinary English tradesman and his well-to-do customers had long been, and indeed still are, those of servility combined with high charges on the tradesman's side, and of delayed and irregular payment on the customers' side combined with affected indif-

ference to the prices. Long credits, bad debts, high prices, and high profits (that is, large advance of retailer's selling price over his buying price) had been the natural consequence of this pseudo-aristocratic régime. The coöperators, by agreeing to pay cash, made possible much more businesslike methods and considerable economies as to bad debts and interest.

In the workingmen's stores, however, coöperation has meant something more. These stores had a remarkable growth in the half century which elapsed since the first small start about 1850. They now number thousands, their members number hundreds of thousands, their transactions run into hundreds of millions of dollars. Their influence reaches the daily lives of a very large portion — perhaps one half — of the working population of Great Britain, especially in the manufacturing regions of the North of England and Scotland. Their example has been followed on a large scale on the Continent, and has not been without its influence in the United States.

A type of the workingmen's store is the Rochdale Equitable Pioneers' Society, the earliest and the most famous of them. The Rochdale stores, as the workingmen's stores of this type have come to be called, sell at ordinary or current retail prices. They make no attempt to effect a saving at this first step. But periodically, say at the end of each quarter, they divide profits among their members in proportion to purchases made by these. The system necessarily involves keeping account of the purchases; a somewhat troublesome process, in which the British stores enlist the aid of the members themselves. Tin tags (or, in very recent times, paper or cardboard slips) are given to members for the amount of every purchase, and these memoranda are turned in by them at the close of the quarter in order to make up a record of each individual's purchases.

This practise of postponing and lumping the profits has two advantages. It has a clear financial advantage: the gains are not divided before they are made. Where the attempt is made to sell at once at lowered prices, the mark may be overshot through failure to make enough allowance for expenses, depre-

ciation, and the like. Then, as has happened with many coöperative experiments, the enterprise eventually goes to pieces. But the Rochdale plan has a much more important advantage than this financial one. The rills of gain on the several purchases, swollen at the end of the quarter to an appreciable volume, are not so likely to be dissipated. The chance is greater that they will be put by and saved. And the stores themselves offer an opportunity and even temptation for saving. The dividends, as the accumulated profits are called, may be left at the store as capital, and when so left are entitled to interest. At the very outset the store needs some capital, which is subscribed by the members (usually in modest sums, the share for each member being £1). But the dividends, largely left at the store, add to the capital. It is in this way that the capital of the workingmen's stores, small at the start, has been brought to great dimensions. The stores not only make savings, but act as savings banks.

This insinuating arrangement for thrift is intentional. The Rochdale stores have always regarded themselves as something more than storekeepers and penny savers. The early promoters and spokesmen of the movement were men of noble spirit, and looked on the cooperative store as but the first stage in a great workingmen's movement. The high expectations which they and their contemporaries cherished have somewhat abated in later days; but there is still an atmosphere of high-minded endeavor. Thus the stores almost invariably refuse to sell liquor, though this might be a source of handsome profit. They make it easy for non-members to join. Strictly, members alone are entitled to share in the dividends. But non-members are often allowed half dividend on their purchases, the amounts so allowed being credited as installments of subscriptions to shares until the full share is paid for and complete membership so secured. Substantial sums from their profits are sometimes allotted for educational purposes and the like. At the annual meetings, especially those of the general coöperative congress, the cause of coöperation and

workmen's independence gets encouragement and laudation; sometimes, no doubt, in empty phrases, but in the main with a real spirit of social endeavor.

The causes of the remarkable success of this form of coöperation in Great Britain are several. Not least among them are the general causes which brought about the great progress of the British working classes, and especially the upper tier of skilled workmen, during the second half of the nineteenth century: a progress in which the trade-unions, the friendly societies, the coöperative stores have played their several parts; while the march of industrial improvement, under capitalist leadership, has sustained it all. The requirement of cash payments has been an important advantage to the stores; another has been the essential weakness of their former competitors, the petty retail shops. No part of the mechanism of the division of labor is so inefficient as that of ordinary retail trading on a small scale. At the same time, ignorance, gullibility, and shiftlessness enable this sort of wasteful business to hold its own with singular persistence. The coöperative store means a resolute effort to eliminate as much as possible of the waste. As with most improvements, the initiation of this one in Great Britain was due to the energy and ability of a few individuals, — picked men among the working classes, — who devised and perfected the system. That system once in working order, it was comparatively easy for others to imitate; just as there are always plenty of business men who can follow the new paths opened by the real leaders of industry.

The success of the British coöperative store illustrates, too, the difficulty of getting rid of accustomed industrial ways, bad though they may be. Abstractly considered, it might be supposed that an enterprising set of retail traders could have pushed out the wasteful petty shop, by doing business on a large scale, on a cash basis, and at lowered prices. Some displacement of this sort has, in fact, occurred in the United States, where the bonds of custom are more easily shaken off. In Great Britain, and on the continent of Europe, habits change

less easily. It required the entirely new method of coöperation, with its appeal not only to the purse of the workingmen, but to their sense of solidarity, to bring about a more rational and economical organization of retail trade.

For many years, the coöperative store movement in Great Britain has been so strong as to go on largely by its own impetus, yet possibly with something of artificial stimulation. The traditional rate of dividend on purchases (something like 10 per cent — on the average, 2*s.* 6*d.* in the pound) has probably been maintained in part by keeping prices high, and not solely by continued saving as compared with current retail practises and prices. The coöperators seem willing to pay a little more in order to get their accustomed dividend. However this may be, the coöperative stores are an established and important element in the industrial system of Great Britain. They have done much to promote the material welfare of the workingmen, and something to train them in ways of common action.

On the continent of Europe there has also been a considerable development of distributive coöperation. As in Great Britain, it has been partly middle class, and so uninteresting; but partly working class, and so more significant. The greatest growth of the workingmen's stores has been in Germany and Belgium, where the movement has been closely allied with that for socialism; although, as will presently be shown, the coöperative and socialistic ideals differ in essential points. The opportunity for displacing wasteful retail trading seems no less on the Continent than in England. If as yet it has on the whole been much less availed of, the explanation probably is that the workingmen of the Continent have felt only in very recent years the stir which roused the English half a century earlier. The progress of this labor movement, as of others, has of late been rapid.

In the United States distributive coöperation has never had the same sort of growth or importance. There have been many attempts, and some successful experiments; but nothing

of any large consequence. The lack of growth in this country is due to various causes. Greater mobility of population, both within cities and between separate regions, is an obstacle. The greater ease with which capable persons rise in the social and industrial scale often deprives coöperators, as it does trade-unionists, of possible leaders. Greater prosperity and larger earnings cause indifference to small savings. And, finally, retail shopkeeping is usually conducted with fair efficiency. The occupation is not under a ban of social depreciation, as it has so long been in older countries, and therefore it attracts more readily men of ambition and capacity. In the urban centers, much of it is carried on with more than fair efficiency. The large shop and the department store have nowhere been carried to so high a pitch as in the United States. None the less, a great deal of petty and wasteful shopkeeping remains. For the working classes, the small retail trader often is half a friend in need, half a swindler and parasite. There is opportunity for a declaration of independence; but the ways and habits of the people seem not to favor independence by the method of coöperation. It is striking that the really successful workingmen's stores in the United States (not many in any case) usually have a membership made up of newly arrived and still clannish immigrants.

§ 3. In some other directions there has been a development of coöperation not less striking than that in retail trading.

In coöperation for securing better credit facilities, the Germans have taken the lead. The name of Schulze-Delitzsch is associated with this movement in Germany, as the name of the Rochdale Pioneers is with the stores in England. Schulze, a native of the town of Delitzsch, conceived the plan of uniting groups of tradesmen and artisans for getting small loans on better terms, and led the way with signal ability in the development of the plan. In essentials, it is simple enough. A knot of persons — tradesmen, artisans, and the like — form a credit society, beginning by subscribing a small initial capital. On the strength of this, and of their own individual liability, they

borrow more, — two or three times more. Schulze always maintained that for these outside borrowings unlimited liability by each member (as in a partnership) was essential; not only because the person lending to the society thus had the security of being able in cause of default to levy on any and every member individually, but because this very liability made the members and managers unfailingly watchful in their dealings among themselves. The total sums got together, their own and borrowed, are then lent out to the members in modest amounts at a moderate rate of interest; this rate of interest being higher than that at which the loans from outside are secured. Even though higher in this way, the rate to members is commonly less than they would have to pay otherwise. And this is the precise object aimed at, — to enable small producers to get the advances they need, without paying the high rates of interest which as individuals they would almost always have to face. By combining their resources and their credit, and by managing the loans among themselves, they are able to borrow at moderate rates. Knowledge of each others' capacity and probity is important, and enables the credit society to make advances and take apparent risks which no outsider would assume except on burdensome terms. As with the British stores, the system, once established and perfected, has proved capable of wide development. The societies number many hundreds (about 900 in 1909), and play an important part in Germany. Some among them are large financial institutions, with members (*i.e.* borrowers) who do business on a considerable scale as tradesmen, merchants, manufacturers.

Though sometimes used for considerable transactions, credit coöperation of this sort is essentially for the small man. Its spread and success in Germany are largely due to the fact that so much of small-scale production still persists in that country. More or less of it persists in any country. Large-scale operations, far spread and growing though they are, have nowhere swept the field entirely. In Germany, perhaps more than in any other advanced country, the artisans and small producers have held

their own, not only through inertia, but through an adaptation to modern methods of production that has given them real vitality. The Schulze-Delitzsch societies have done much to maintain them. The unflagging industry of these Germans and their content with sparse gains, have in turn provided a favorable soil for the credit coöperation.

Another phase of the same general movement in Germany is associated with the name of Raiffeisen, who also was a leader in developing an effective scheme. Raiffeisen societies are chiefly agricultural, and serve the needs of the great class of peasant proprietors in southern and western Germany. Their organization is similar to that of the Schulze-Delitzsch societies, which are commonly urban or semi-urban. Some capital is subscribed by members; more is got from outside (sometimes with government aid). The loans to members are for longer periods than in the urban societies, as is necessary if they are to be of real service to agricultural producers. Their spread has been extraordinary; there are thousands of societies, and probably one half the smaller agricultural proprietors of Germany are enrolled as members. Each society has comparatively few members, and covers a limited region; the essence of success is neighborly knowledge and supervision.

Other sorts of societies flourish in Germany, — societies for the purchase of materials, for the sale of products, for the purchase and use of machinery too expensive for any one member. The credit societies, as well as these, have spread into other countries. Credit coöperation has had a large development in Italy, where also it has proved to meet the needs of the class of small tradesmen and artisans; and it has spread similarly among the agricultural classes of northern Italy. It is odd, and not readily explained, that in France no one of these forms of coöperation — whether in storekeeping, for credit, or for other analogous ends — has had any considerable growth.

A striking advance has been made in Denmark, and to some extent in other Scandinavian countries, — coöperation among agricultural producers, in collecting milk and making butter,

curing bacon, packing and shipping eggs. A large export trade, especially to England, has been built up on a basis of coöperative effort. The English naturally look on this achievement with envy, and wish that their own agricultural producers might adopt the same methods with the same success. But for success of this sort a system of land ownership in small parcels is necessary, or at least one of long-term tenancy with assured compensation for improvements; and not only such an assured position, but habituation of the cultivators to it. The English system of landowning and land tenure constitutes the great obstacle to the spread of this sort of coöperation in England. Possibly in Ireland, where the ousting of the landlord and the transfer of the land to the cultivators are being accomplished, there is a promising field; and an earnest effort is now being made by the best friends of the Irish to teach them the principles and practise of agricultural coöperation.

§ 4. All the schemes outlined in the preceding sections are for partial coöperation. They leave the members independent in their main industrial activities. Very different is the case with coöperation in production. Here the endeavor is made to get rid of the business man at the vital place. Workmen get together, and procure in some way (by saving, borrowing, public aid) an initial capital. They possess their own tools and plant, buy their materials, sell the output, and divide among themselves the proceeds. They are their own managers and their own employers; and if successful they can secure business profits as well as ordinary wages, and, not least, can emancipate themselves from the dependent position of the hired employee.

Evidently, if this were done on a large scale, social conditions and the organization of industry would be profoundly affected. The employing capitalist would disappear. The consequent changes would be vastly greater than those from the spread of the other forms of coöperation. Distributive coöperation, if carried to its utmost conceivable development (and it is far from being carried to that stage, or likely to be)

would mean simply the displacement of the retail shopkeepers by a set of salaried agents. Coöperation in credit touches only some fringes and loose ends of the modern industrial system. The various phases of coöperation in agriculture are designed to aid the independent farmer, and strengthen his position, not to supersede him. But productive coöperation, if carried out to the full, would modify social and industrial organization at a crucial point. Even if applied not universally, but on a scale comparable to that of the other forms, — if it could show hundreds of societies, and with members by the tens of thousands or hundreds of thousands, — its spread would mean something of high import for the present and future.

Unfortunately coöperation in production hardly exists; or, if it exists, only to such an extent that the thing cannot be said to be unknown or untried. A considerable number of experiments in it have been made in various countries. There have been sporadic cases of sustained success. But the record on the whole is one of failure.

This is true even in France, where the cases of success are most numerous. As was just noted, the other forms of coöperation seem to find no favorable field in France; but at least the disposition has appeared to make trial of production by united workmen. The state has freely aided workmen in these attempts, by loans and by contracts, from the revolution of 1848 down to our own time. State aid is often said to be dangerous to coöperators; and probably it is true that those coöperators are most likely to succeed who begin in a small way on their own savings, and depend throughout on their own industry and efficiency. Yet some societies aided by the state in France have had a long and successful career. The same is true of a few societies that have grown out of the famous profit-sharing experiments.[1] The striking thing is that whether aided by the state or not, whether started from the beginning as productive societies or the outgrowth of profit sharing, they are so few. There has been no lack of propaganda, of oppor-

[1] See above, Chapter 56, § 1.

tunity, of support. But the net result is as nothing, compared to industry in general, even compared to the growth of other forms of coöperation.

In other countries there is the same insignificance of the productive societies. In Great Britain a very few have held their own. In recent years these have been bolstered up by the great distributive stores, which have bought by preference some products from the producing coöperators. This sort of patronage is not necessarily enfeebling, any more than is public aid. But that it is welcomed, or even resorted to, shows that the prospects for independent success are not good. Unless the coöperators can do so well in quality and price of their goods, and in the earnings which they secure for themselves, that they call for no favors, but simply compete with employing capitalists on even terms, there is no chance of any large development.

It is striking that in Great Britain the coöperative stores have themselves entered in another way on the field of production. The great wholesale societies, and some of the individual retail societies, have established factories and workshops of their own, for making shoes, clothing, hardware, biscuits, jams, and pickles; they have even tried tea planting in Ceylon and (with doubtful success) farming on their own account in Great Britain and Ireland. But all these establishments are managed by superintendents sent down from the coöperative stores. The workmen in them are hired in the same way and substantially on the same terms as in ordinary private establishments. Obviously, this is a very different thing from true coöperation in production, where the workmen find the managers among their own numbers. The success of the stores in their subsidiary establishments is due, no doubt, largely to the fact that they have an assured market, and confine themselves to making staple goods by staple methods. None the less, it is surprising that the associated workmen should have achieved success in management by this route, when they have failed of it by the more direct route.

The essential difficulty in the way of coöperation in production is that it attempts to supersede the business man where he is most needed. Its failure is at once a result and a proof of the rarity and the importance of business leadership. Intelligence, imagination, judgment, courage, powers of organization and administration, — all the qualities needed for success in business management, — are possessed in the right combination by few individuals. Coöperation cannot dispense with these leaders; it would have to enlist them. But no spur to the full application of their powers has been found comparable to that of individual ownership and individual gain. Individuals of high capacity are sometimes found at the head of coöperative enterprises, working unselfishly for the cause and for their fellows. Such apparently has been the case in some of the great British stores. Such, too, has been the case in some of the great profit-sharing enterprises. But these are exceptions. Most men exercise their faculties to the highest pitch when working for themselves and their families. Possibly a substitute for the driving force of self-interest may be found in an entirely different organization of society; of this more will be said elsewhere. But coöperation, put on trial in the midst of an individualistic and capitalistic organization, has failed to enlist the needed leadership.

The complications of modern industry make coöperative production more difficult. Large-scale operation, great plant, elaborate processes, intensify the need for managers of ability and resource. But even in those comparatively simple industries which are developed but little beyond the handicraft stage, — and there are not a few such, in various directions, — the coöperative plan has not been found to work. As with profit sharing, one might expect to find a greater degree of success in these sorts of business; but in neither case is there any clear indication from experience that the character of the industry makes a great difference. Though the coöperators undertake an industry requiring comparatively small plant and no elaborate organization, and though they possess in their

own ranks the right man, — perhaps a hidden genius, — it is far from certain that he will be put in charge by his fellows, and kept in charge. There is likely to be jealousy, vacillation, stagnation; and the industrial world is moving farther and farther away from the methods of town-meeting democracy. The capable man finally sets up for himself, or enters the employ of others in an administrative post. If these difficulties are serious in the simpler industries, they become more and more so with the growing scale and complexity of modern business.

Hence the conclusion both from experience and from general reasoning is that coöperation is not likely to revolutionize the social order. It may grow considerably in some of the ancillary operations already carried on with success. But the hopes entertained a generation ago by many economists, that it was only in the first stages of a far-reaching development, are now cherished by few. Other ways of mitigating inequality and widening opportunity have come to enlist the enthusiasm of social reformers, — labor organization, labor legislation, extension of public management and control, socialism halfway or all the way. To these the future seems to belong, not to coöperative methods.

References on Book VI

A compact discussion of the topics in this Book is in T. S. Adams and H. L. Sumner, *Labor Problems* (1905). On many problems there is keen discussion in A. C. Pigou, *Wealth and Welfare* (1912). H. Herkner, *Die Arbeiterfrage* (5th ed. 1908), systematically covers the field. On trade-unions, the elaborate book by S. and B. Webb, *Industrial Democracy* (1902), is of high quality; written with special regard to English experience, and stating without reserve the case in favor of the trade-union. On the American situation excellent studies on some phases are in J. H. Hollander and G. E. Barnett, *Studies in American Trade-Unionism* (1905). Recent books on labor organization in the United States are F. T. Carlton, *History and Problems of Organized Labor* (1911); H. Marot, *American Labor Unions* (1914). On Australasian experience, see V. S. Clark, *The Labor Movement in Australasia* (1906); and a series of articles by M. B. Hammond, in the

Quarterly Journal of Economics, 1914–15. On the history of labor legislation in England, B. L. Hutchins and A. Harrison, *A History of Factory Legislation* (1903). J. Rae, *Eight Hours for Work* (1894), is a good inquiry on experience to the date of its publication. On workingmen's insurance and allied topics, see H. R. Seager, *Social Insurance: a Program of Social Reform* (1910), brief and excellent. More detailed and more informational are L. F. Frankel and M. Dawson, *Workingmen's Insurance in Europe* (1910); I. Rubinow, *Social Insurance* (1913); W. H. Dawson, *Social Insurance in Germany* (1912). W. H. Beveridge, *Unemployment* (1910), is an able book, at once sympathetic and discriminating. A good general account of the coöperative movement is C. R. Fay, *Coöperation at Home and Abroad* (1908). Compact and able is A. C. Pigou, *Unemployment* (1913).

For more detailed bibliographical memoranda, see the *Guide to Reading in Social Ethics and Allied Subjects*, published by Harvard University (1910).

BOOK VII

PROBLEMS OF ECONOMIC ORGANIZATION

CHAPTER 60

Railways

§ 1. The present Book deals with the broad aspects of the social questions. It is concerned with the same fundamental problems as the preceding Book, — inequality and the ways of mitigating it. But it considers the relation of the state not so much to the laborer as to the capitalist and employer. What need is there, what are the ways, of controlling private business management or of supplanting it?

The railway is the most important among modern industries, both as regards its effects on the economic structure at large and as regards its own special problems. More than any other single factor, the railway has brought about the industrial revolution of the last half century. Its cheapening of transportation has immensely promoted far-reaching geographical division of labor, large-scale production, impending monopoly, great fortunes. The railway itself is a vast enterprise, with a tendency to monopoly conditions in its inherent workings; it threatens in private hands to become an *imperium in imperio;* it presents most urgently the problems of public control and public ownership.

Before entering on the problems of public regulation or management, it is desirable to analyze some of the economic characteristics of railways, since these must be understood before the larger and more difficult matters can be intelligently dealt with.

In its most important economic aspect, — as a freight carrier, — a railway is simply an instrument for bringing about a cheapening of the things transported because they are produced more advantageously at one place than at another.

People commonly forget that all agencies of transportation are but means of furthering the geographical division of labor. An enormous amount of effort is given to activities which are simply ancillary, — which serve only to facilitate the more effective apportionment of the community's labor. The railways of the United States in 1900 employed one person for every twenty-nine who were gainfully occupied.[1] This figure takes account only of those employed in the current operation of the roads, not of those who had worked on their construction; and we shall see presently that the amount of such previous work, as indicated by the capital investment, is exceptionally large. In estimating the total of the ancillary activities, we should have to reckon also the millions of teamsters, merchants, salesmen, clerks, and so on, — an enormous host, all engaged in facilitating the transfer of things from places where they can be produced cheaply to other places where their expense of production would have been greater. No part of this labor is so effective in promoting exchange as that of transportation by steam railways. A comparatively slight advantage in production, which in former days would have been offset by the expense of transportation beyond a short distance, now suffices to concentrate industry in one region, and to induce exchange on a great scale between it and other regions.

It follows from this obvious but often forgotten fact that a railway is not economically advantageous to the community unless it pays its way. This conclusion is not in accord with a common opinion. It is often said that a railway or other means of transportation may bring gains to the community, though it be not profitable to its owners. Similarly it is often argued that a government, in operating a railway, may accept with composure a financial loss, because the people as a whole have gained something that offsets such loss. The contrary view seems the just one. No gain comes from carrying a thing from one place to another unless it can be produced at the

[1] The total number of persons gainfully occupied was, in round numbers, 29,000,000; the steam railways employed a trifle more than 1,000,000.

first place so much more cheaply that it can afford the cost of carriage to the second. Ability to stand the transportation charge is the test of the utility of the carriage.

Needless to say, particular sections and particular individuals may be benefited by transportation at less than cost. The state of New York is now (1909) engaged in a great enlargement of the Erie Canal, at an expenditure of one hundred millions or more; and has provided (this by the hard and fast method of constitutional enactment) that no tolls shall be charged for the use of the canal. When the canal is finished, it will be as if nature had made a navigable river. Doubtless, more traffic will go to and through the city of New York; the rents of landowners there will swell still further; some consumers may gain in having goods cheaper. But it is at least an open question whether the labor which built the canal will yield its full normal results to the community. The test of its having been worth while must be whether canal tolls, sufficient to pay for the labor (and waiting) involved, could be borne by the traffic. It would be desirable, obviously, to have all transportation free, and to have every commodity produced once for all where it could be most cheaply produced. But so long as transportation involves labor and waiting, a real advantage from exchange is got only if, at the point of consumption, the total cost can be met, including that of transportation.

It will sometimes be of advantage to open up a new country or a new region, by railways (and the argument applies equally to wagon roads, canals, steamship lines) which do not pay at the outset. This case is analogous to that of protection for young industries. Eventually the railway should pay; if the losses of the early stage are not recouped, they are definitive losses. It follows that where subsidies are given to encourage railway construction, they should be in the nature of loans, to be reimbursed when the stage of profitable operation has been reached.

The case, in other words, is different from that of industries which yield utilities more directly. Some industries there are

in which financial loss is consistent with public gain. A water supply may be managed by a municipality on terms and methods which, while involving a deficit, none the less bring a real advantage to the public. A superabundant supply of good water brings hygienic gains, as well as other more direct satisfactions, not necessarily measured by the price people are willing to pay. The post office also may be administered with good reason on noncommercial principles; for the diffusion of intelligence is a boon not measured by its market value. Hence the deficit which the United States incurs from its cheap carriage of books, periodicals, and newspapers is not necessarily a public loss, though a similar deficit on a parcel post for merchandise would be.

Passenger traffic presents a somewhat different case from freight traffic. Some passenger traffic is much nearer the stage of utility and satisfaction than freight traffic. Most of it, to be sure, like freight traffic, is only ancillary to the division of labor; such as the constant going of people to and from their places of work. Pleasure traveling alone is a consumers' utility. The only serious ground for managing passenger traffic on noncommercial principles is to be found in a possible immobility of labor or crowding of population. It is conceivable that cheap fares under congested conditions may bring a real social gain not measured by what the individuals affected are willing to pay.

§ 2. Railways have two marked economic characteristics, — not such as to make them in the last analysis different in kind from other industries, but so great in degree as to bring railway problems in a class by themselves. These characteristics are, first, the great size of the plant; and second, the fact that the operations are conducted largely at joint cost. Both have important consequences for the problems of public regulation.

A railway's plant is large, not alone absolutely, but relatively to the current output. As compared with the capital invested in plant, the annual gross receipts (the measure of the output) are but a small fraction, — one fifth or one tenth. A manu-

facturing plant in which the plant merely equaled in value the annual output would be regarded as having a relatively large fixed investment. How much more the railway, in which the plant is five or ten times as great in value as the annual turnover!

Connected with the large plant is a great flexibility in its use, and a tendency to decreasing cost per unit of traffic. When a railway is once built, its roadbed and other fixed equipment will serve, within wide limits, whether the traffic be large or small. An increase of traffic, though it means some increase in operating expenses (probably even here not a proportionate increase), ordinarily calls for no increase of plant. Hence, for the traffic as a whole, it means decreased expense per unit. This is true, of course, only so long as the fixed equipment does continue to suffice for enlarging traffic. With continuing enlargement, the stage is eventually reached where the plant no longer suffices. A single-track road eventually may need to be double-tracked, or the double-track road four-tracked, the stations and terminal facilities enlarged, and so on. Then there often ensues an uneasy period for the railway manager. A great and probably rapid enlargement of plant is called for, while the traffic, though too heavy to be handled with the old plant, is not growing rapidly enough to insure at once full employment and satisfactory earnings for the enlarged plant. The railway, after having been overworked with its former outfit, has for a while not enough business for its new outfit. This sort of trying transition stage is most noticeable when a railway passes from single track to double track, yet shows itself almost as much in the enormous new facilities needed in regions of dense population and traffic by roads already double-tracked or even four-tracked.

Through all these changes, and with the irregularities which ensue from the gradual growth of traffic and the occasional abrupt increase of plant, there runs a tendency to decreasing cost per unit of traffic; that is, a tendency to increasing return. A double-track road, with a sufficient density of traffic,

carries freight and passengers more cheaply than a single-track road; a four-track road more cheaply than a double-track one. It follows that two single-track roads over the same route are a wasteful application of the community's resources, as compared with one double-track road; and so on. And it follows further that concentration and monopoly promote the thriftiest ways of laying out the railway net.

One important consequence of a railway's large plant is the frequency of sudden transition from financial failure to financial success. This is especially the case in rapidly growing communities. When a road is first built, the traffic may not be large enough to make operation profitable. Gradually the traffic grows; and, as it grows, the road is able to carry it with the existing plant, and also with operating expenses largely unchanged. A stage is thus reached where the traffic and the revenue from it are such that a profit is earned, though just before, with a traffic but little smaller, the capital invested had secured little or nothing. An abrupt change in financial outcome takes place, and with it a sharp change in the market price of the railway's securities. For the same reason, fluctuations in general business activity are of special effect on railways. In times of depression and slackened traffic, they cannot lessen their heavy capital charge and in large degree cannot lessen their operating expenses. In times of revival and growing traffic, their receipts increase, without an increase in their expenses at all corresponding. Hence, in new countries, or in countries subject to great fluctuations in business conditions, railways and railway securities offer peculiar opportunity for speculation and speculative investment, and for large gains by the shrewd and farsighted. These conditions exist in the United States more markedly than in any other country, and have had much to do with the great fortunes made from railways in this country. Sometimes the first investors — the "builders" — of railways have reaped large gains, by waiting through thick and thin until the growth of traffic has made the enterprises profitable. Quite as often, those who have

bought control of railways in the intermediate period of uncertainty have made fortunes by the rapid transition from loss to profit.

§ 3. A second peculiarity, no less important in its consequences, is the element of joint cost in railway expenses. In good part it results from the first. When any large plant is used for diverse products, the case is so far one of production at joint cost. So it is with a railway. The same roadbed is used for passengers and freight, and for the different kinds of passengers and freight. If the outlay for plant were the only expense incurred in rendering the service, the case would be one completely of joint cost. There are, of course, the operating expenses in addition. But the expense of the plant (represented chiefly by interest on the investment), forms an unusually large part of the total cost of transportation. In other words, return on capital is an unusually large part of the expenses which must in the long run be recouped. In so far, the principle of joint cost is applicable without qualification.

But the operating expenses also represent in large part joint cost. Many of them are incurred for the traffic as a whole, and must go on whether or no individual items of traffic are undertaken. Such is most obviously the case with the large expenditure for maintenance of way. The roadbed must be patrolled, kept in order, and repaired from the wear of exposure and use; and this whether there be much or little traffic, one or another kind of traffic. Safety appliances must be there in any case. Much station expense, especially at small places, is the same whether business be large or small. So it is as to general office and administrative expenses. All such expenses serve, for example, equally for passengers and freight, and cannot be said to be incurred specifically for either, or to be separable as expense for one or the other. At least one half of the total operating expenses of a railway are impossible of apportionment to any class or items of traffic, and thus stand for joint cost.[1]

[1] An experienced railway manager has recently (1911) stated that "about fifty-five per cent of the expenses of operation go on uniformly, regardless of

Even as to those items of expense which are not common for the traffic as a whole, there is often an element of joint cost for a considerable block of traffic. Those operating expenses which are not wholly joint vary in the main according to the number of trains run and the distances run by them; that is, according to train miles. Every train mile means so much separate outgo for wages, fuel, wear and tear of rolling stock and of track. But a train may have ten cars or thirty, and the cars may be full or empty. Train miles, and consequently the immediate expenses, will be substantially the same whether the train be long or short, full or empty; but the tonnage carried will be very different. It is a cardinal maxim in railway operation that every train ought to have as many cars as the engine can haul, and that every car ought to be loaded to its full capacity. But this ideal maximum utilization of the rolling stock — this ideal fitting of ton miles to train miles — is impossible of attainment. There are inevitably some short trains (especially as to local freights) and some cars empty or half full. For each train by itself there is one cost, joint for all that it carries.

The same situation is even more obviously present in passenger service. Passenger trains must run on their schedule time. Their expense is substantially the same whether the cars be full or empty, whether they have the maximum number of cars an engine can haul, or only half or a third of that number. A very great increase in traffic entails, it is true, an increase in passenger train miles. But a very considerable increase in passengers and in revenue may come without any additional train miles; that is, without any appreciable difference in expense. A mail car, excursion car, sleeping car, private car, attached to a regular passenger train involves no additional expense; the whole train is operated at one joint cost. On European railways, first-class, second-class, and third-class

the volume of business done" (F. A. Delano, in *The World To-day*, February, 1911). See also the elaborate figures in the Reports of the Wisconsin Railroad Commission, Vol. I, p. 382 and *passim*.

carriages commonly form part of the same train, and are operated at one joint expense for the train as a whole. The apportionment of charges among the different classes of passengers proceeds (in a rough way) on that basis of utility or demand, which, as has been shown, dominates where cost is joint.[1]

Many peculiarities in railway rates are explained by the principle of joint cost. It underlies the much-misconceived practise of "charging what the traffic will bear." That practise, it is true, describes also another and very different aspect of railway rates, — their monopolistic character, — of which more will be said in the next chapter.[2] As commonly used, the phrase refers to the apparent failure of railway rates to conform to cost of production.

No item of traffic, it is obvious, will be carried at a charge less than the separate expense involved for it. But above the small separate expense is the great mass of joint expense; and that joint expense must be got back somehow, or else railways will not be built. Some items of traffic will "stand" a heavier charge than others; that is, they will continue to be offered even though the transportation charge be high. Other items will "stand" only a low charge; that is, they will not come unless the charge be low. The joint expense will be got back from the former set much more than from the latter. This is the main explanation of the classification of freight; that is, the arrangement of articles in classes, with a higher rate per unit of weight on some than on others. Railways in all countries, whether under public or under private management, habitually charge less per ton mile on cheap bulky articles than on articles having high value per unit of weight. Thus coal, ores, lumber, are "low-class" articles, on which rates are relatively low; textiles and groceries are "high-class" articles, and on them rates are high. The coal, ores, lumber, will not be offered for transportation unless rates be low; the traffic will bear no

[1] See above, Book II, Chapter 16, § 1.
[2] See below, Chapter 61, § 6.

more. The textiles and groceries will be offered even though the charge be relatively high; the traffic will bear it. The textiles and groceries, therefore, will contribute much more to the general (joint) expenses than the coal and lumber. In railway parlance, the "profit" on the one is greater than on the other; which means that there is a greater excess of receipts over separable expenses. Where both kinds of commodities are carried on one and the same train, there are virtually no separable expenses for either. Barring such items as loading and unloading all the expense is joint, and the principle of joint cost has full play.

§ 4. To explain an economic phenomenon is by no means the same thing as to justify it. People constantly confound these two proceedings, and suppose that because an economist shows how a given result comes to pass, he therefore implies that it is a right result. That the principle of joint cost explains (in the main) the practise of charging what the traffic will bear does not prove the practise to be just.

As to the question of propriety or justice, there is much hazy talk among persons who have had to give attention to railway matters but have not been versed in general economics, — such as railway managers, and judges and public officials concerned with the enforcement of rate regulation. These often speak as if it were obviously and intrinsically "just" that a commodity having higher value should be charged higher freight rates. It must be confessed that some trained economists have spoken in the same loose way. Yet no one would apply such a notion to transportation by pack mule or wagon; the charge here is the same (aside from insurance and the like) whether the articles be silks and precious metals or coal and brick. Being habituated to a different mode of fixing railway rates, people think of it as righteous; for they commonly regard the wonted order of things as just.

The justification of charging what the traffic will bear must rest on a further principle: namely, that it conduces to the fullest utilization of the railway. More service is got by the

community on this plan than would be got on a plan of uniform rates. If all rates were on a uniform toll plan, being the same per ton per mile on all freight, — a so-called system of "natural" rates, — bulky articles would have to pay more than now, and compact and expensive articles would have to pay less. But very little more of the expensive freight would be offered because of the lowered rates; whereas the amount of the bulky articles offered for transportation would be greatly diminished. The only way in which the bulky articles can be made to move in great quantities is by carrying them at low rates; just as — to resort again to a comparison now familiar to the reader — the only way in which cotton seed can be disposed of is by offering it at a price which is low as compared with the price of cotton fiber. Most of the expense involved in carrying the bulky articles is incurred anyhow; it is involved in the general or joint expense of building and operating the railway. The only way to get the full utilization of all this labor and expense is to fix the rates in such manner that the transportation shall come.

The geographical division of labor has been most profoundly affected by railways, in the production of these very articles having great bulk and weight relatively to their value, — coal, ores, lumber, and the like. The vast development of modern industry could hardly have taken place without their transportation on a great scale at low rates. Through the general practise of charging what the traffic will bear, and through that practise only, the railway plant has been made to produce its most far-reaching results.

§ 5. The principle of joint cost further aids in explaining why under competition railway rates are low, and in the absence of competition are high or at least less low. The explanation, again, leads in part to a justification of low competitive rates, in part does not.

Where a railway competes with a water route, or with another railway, it will accept as low a rate as its rival. It must do so, or go without the traffic. If, indeed, it could reduce its ex-

penses *pari passu* with a reduction in traffic, it might withdraw from the competition at a comparatively early stage. But its expenses go on, in the main, whether the competitive traffic is carried on or not. So long as it gets anything at all over and above the separable expense which this traffic entails, it will find profit in accepting it, even at very low rates. Meanwhile, it must somewhere get back its joint or "general" expenses; and the noncompetitive traffic is charged a comparatively high rate. Hence a railway will not infrequently be found to charge a higher rate for a short haul than for a longer one.

Where the competition which thus leads to the lower rate on the longer haul is from a route cheaper by nature, — say, from a water route, — the result is not only inevitable, but is justifiable on the general ground of full utilization of the railway plant. The rates of transportation between the two competitive points — say New York and San Francisco, or Boston and Savannah — will be low in every case. The railway, in carrying the traffic at these low rates, enables its plant and its general operating force to do so much more service for the community.

Where, however, the competition which leads to the low rates between distant points is simply between rival railways, the case is not so plain. It is by no means clear that more service is got from the same plant. The outcome may easily be, not that more use is got from the railway, but that the use is got in a different place. The competitive points, favored by low rates, may grow; but intermediate points, hampered by higher rates, may decline (or fail to grow). If there were no railway competition, — if there were but one railway, or if the competing railways were to unite, — there would be nothing in the conditions of operation to make rates low on the longer haul. The general presumption is that rates should vary with distance. A longer line of road necessarily costs more to build and operate than a short one; the total cost of the longer haul must be paid for somehow. It is a safe general rule that charges should be higher as distance, and therefore presumably

cost, grow larger. In other words, a lower charge on a longer haul must stand on the defensive. The presumption as to public advantage is against it, and there must be clear evidence of public gain before the practise can be said to be justified. This principle, long disputed in the United States, was tentatively affirmed by the federal legislation of 1887, and definitively established by that of 1910; the act of the latter year prohibiting once for all a larger charge on a shorter haul without express authorization from the Interstate Commerce Commission.

§ 6. Some other consequences of the principle of joint cost have been and are of large social significance.

Railway rates are necessarily flexible. Even though rates as a whole be so fixed as to cover the whole cost, there is no clear relation between any specific rate and the specific cost of carriage. The absence of any precise measure of cost of service makes it plausible to adjust the charge, apparently arbitrary as it must be in any case, according to all sorts of real or supposed benefits. Where governments manage railways, it leads easily to the determination of rates on other grounds than those directly related to transportation. It may be supposed, for example (according to the protectionist notions so widely prevalent), that imports are bad and should be discouraged, while exports are advantageous and should be promoted, — a notion which leads naturally to high rates on things imported and low rates on things exported. Such is the practise on the Prussian railways at present, especially as to the exports. If there were clearly a financial loss in carrying at low rates the goods destined for export, governments would hesitate as long before conceding specially low rates as they do in granting direct money subsidies on exports. The question of money loss or gain is obscured when no specific railway rate can be shown to involve a direct loss. Again, low rates to favor a particular set of constituents, or a given locality, will be similarly easy to bring about, and may be similarly in apparent accord with the general ways of rate making. To arrange railway charges on

a "just" basis, as is the aim of a government in managing a railway, is a task of peculiar difficulty and complexity.

The same difficulty exists, of course, when a government, though it does not itself operate the railways, regulates the rates of private corporations. This is what the government of the United States sets out to do, as to the interstate traffic under its control. The Interstate Commerce Act of 1887 says that rates shall be "reasonable." What is the standard or measure of reasonableness in rates? It is not difficult to answer this question as regards the general range Rates as a whole should not be higher than will suffice to yield a normal return on the capital invested in railways, a "normal" return being understood to include not only interest, but something in addition, by way of compensation for risk and judgment. Even though no absolutely precise settlement of such a rate of return be feasible, an approximation to it can be reached, — six per cent, or eight per cent, or something of the sort. But this helps very little as to any individual rate. Whether the individual rate is "reasonable" is a question of its right adjustment to the traffic demand and to the best utilization of plant and equipment. It happens that this question of principle has not often been deliberately considered, either in the United States or in other countries. The general methods of railway rates, as they developed under the tentative and profit-seeking ways of privately managed railways, have been accepted once for all. That rates should be lower on bulky goods is thought to be obviously "right." Similarly, the existing geographical adjustments of rates, with wide variations in different regions and between different places, have been left in the main undisturbed. Probably this rule-of-thumb policy has been the wisest one. Any scheme of symmetrical rates based on supposed principles of justice or naturalness would have fettered the fullest development of traffic by railways.

§ 7. Still another consequence of the principle of joint cost has been, in the United States especially, a perfect chaos in the rate system. This was unmistakeably the situation before the

Interstate Commerce Act was passed in 1887; and though matters have mended since, much of chaos still remains. In this country, as in others, railway rates were developed tentatively. The possibilities of carrying bulky goods at low rates over long distances, and of the other adjustments of rates on different articles and to different regions, were discovered gradually. No settled tariffs of rates existed in the early days, or, if any existed, they were disregarded. All rates were "special" rates; that is, were reached in each case by higgling between shipper and carrier. This method, or lack of method, no doubt promoted flexibility in rates, high utilization of the railway plant, and economy in its operation; but it caused also grave evils.

One great evil was the power in the hands of railway managers. With the widening of the market due to cheap transportation, the price of this very transportation became of crucial importance. Success in business was possible only to the man who got as low rates as his competitors. Favors in rates might easily mean a fortune. The railway traffic manager could make or unmake this man or this town. Such power over the fortunes of others can be intrusted to very few men without being abused. It constitutes perhaps the strongest reason for public control, whether directly by government management or indirectly by government regulation.

In the United States, the power was sometimes used corruptly. Those in control of railways — managers and directors — arranged for themselves, as traders and shippers, lower rates than other shippers got. This sort of practise is not only corrupt, in that it violates the fiduciary obligations of directors and managers, — their most obvious legal and moral duty is to manage the railway with a single mind to the advantage of the shareholders; it is also inconsistent with the fundamental principle that competition should be on even terms. Here the game was played with loaded dice.

But, in the main, favors in rates were given not in arbitrary or corrupt ways, but under the stress of railway competition. That competition, as has already been noted, is made peculiarly

severe because of the conditions of joint cost. Rather than let any particular item of traffic go elsewhere, the railway manager will accept any rate which yields something over the expense (comparatively slight) entailed by that specific item. A large shipper, in dealing with competing railways, can play off one against another, and secure for himself special rates. In the old days, corruption or semi-corruption of the traffic manager, — say by offering him shares of the large shipper's corporation, — played its part. But competition between railways, and their inevitable eagerness to "get the tonnage," was the main cause of the favors to large shippers.

Not infrequently, in cool recognition of this situation, a railway would deliberately select some individual shipper as its agent in securing what was regarded as a "fair" share of the competitive traffic. Such a favored person, of course, had a great advantage over others in the same sort of business. He could carry on operations on a larger scale, and was likely to wax strong and rich. This was not unwelcome to the railway, so long as he enabled it to hold the traffic as against rival roads. But eventually, in not a few cases, these favored shippers became so strong and rich that, from having been the servants of the railways, they become their masters. Their operations grew to be on so huge a scale that they could throw traffic from one road to another, and bring any and every road to accept their terms; that is, to give them lower rates than the ordinary shipper. Such was the case conspicuously with the Standard Oil Company, which began as the favored shipper of one of the Eastern trunk lines (first of the New York Central, then of the Erie also) and by this advantage finally was enabled, or at least aided, to get into its hands so preponderant a share of the business of refining and shipping oil that it could virtually dictate its own terms to all the railways. Such, too, was the development of some of the great Chicago packing houses.

These extraordinary effects of railway competition show the modern business system at its worst. They have unexpectedly

and artificially accentuated the trend toward large-scale operations; they have placed a premium on untruthfulness, intrigue, bullying, spying. Yet it must be said also that this same factor of railway competition has immensely promoted efficiency in operation. Every railway manager was put on his mettle to carry the tonnage at a profit, even with low rates. Freight rates on American railways are remarkably low, and especially low on that long-distance traffic which has been most the subject of competition.

§ 8. "Rebates," of which so much is heard in discussion of American railway regulation, are not bad *per se*. They are bad if not given to all shippers on the same terms. The thing which legislation and public opinion try to prevent is inequality of rates. Rebates and the like devices are objectionable because they are the means of discriminating between different shippers. In the early days when railways were looked on as businesses like any other, it was natural to leave their charges to the higgling of the market and to accept without objection those inequalities which higgling always brings about and at the same time ordinarily tends to minimize. As the immense importance of railways in affecting other businesses came to be seen, higgling and discrimination fell into opprobrium, and rebates and the like devices were prohibited.

Rebates, again, are not welcome to railways. The railway manager (unless by chance in corrupt collusion with a shipper) does not wish to cut his rate; he wishes to get as much as possible. In the vast majority of cases, he is forced to a concession by the competition of a rival route.

The natural step for competitive railways is to put an end to competition by combining to fix rates once for all. Hence railway pools and combinations appeared at an early date, as a means of putting an end to "ruinous" or "cutthroat" competition. Such pools are hard to hold together, at least under the English and American law, which make them void and nonenforceable;[1] but, so far as they go, they check the tendency to

[1] Compare Chapter 63, § 1.

special rates for favored shippers. They are thus a means of furthering equality of treatment and equality of industrial opportunity. Whether or no it be sound policy to prohibit combinations and price agreements in other industries, almost all careful observers of railways agree that as to them such prohibition is unwise. None the less, our Interstate Commerce Act prohibited combination of any sort; and the prohibition was made even more drastic by the general anti-monopoly act of 1890, known as the Sherman Law. The Interstate Commerce Commission has repeatedly recommended the repeal of this sort of legislation, and the authorization of pools and rate agreements. The anxious fear among our public men of being supposed to favor monopolies has prevented any relaxation of the stringent restriction; and this, even though the recommendation is coupled with the proviso that the rates fixed after pooling or agreement should be subject to public approval (say that of the Interstate Commerce Commission). In the absence of this means of escaping the stress of competition, railways have been impelled to combine once for all, rival roads being absorbed under single control. The consolidation of the railway net into great systems, which went on so rapidly during the twenty years after the passage of the act of 1887, though by no means due solely or even chiefly to this cause, was promoted by the fact that railways were deprived of their best means of self-defense against competition. Our legislation on railways has been in this regard inconsistent with itself. It has prohibited discrimination, yet has also prohibited one of the means of checking discrimination. It has prohibited combinations and pools, yet has promoted the rapid march of complete consolidation.

The great and flagrant inequalities in rates, by rebates and otherwise, have been largely brought to an end by the activity of the Interstate Commerce Commission and the Bureau of Corporations, and by the increasingly stringent penalties established by successive laws. An aroused public opinion has contributed to this betterment; the elimination of competition

through the consolidation of the railways has contributed even more. So long as railway competition persists, it will always be difficult for traffic managers to resist the temptation of securing larger tonnage by favors to this or that shipper; and ingenious devices will be sought — in the way of allowances for switching or for damages, manipulations of one sort or another — for "defeating" the nominal rate. The prohibitions and penalties of legislation would be made much more effective if railways were allowed to make rate agreements openly. Here, as elsewhere, our public policy is still ruled by a panic fear of monopoly, and an unwillingness to face the essential problem, how to regulate monopoly successfully.

CHAPTER 61

RAILWAY PROBLEMS, *continued*

§ 1. Railways have been the most important agents in increasing the disparities of wealth in modern times and in bringing about great fortunes. They have so operated indirectly, by promoting the general tendency to large-scale production. They have had the same effect more directly, through the tendency to increasing gains with their growth, through the concentration of their ownership, through the possibilities of speculative manipulation. Their direct effects on the distribution of wealth have appeared most markedly in the United States, and it is with the course of development in this country that the present chapter is chiefly concerned.

First, as to increasing gains from their operation. A railway in a growing country (and the railway itself causes a country to grow) is largely in the position of good land. It tends to advance in value and to secure an increment of economic rent. This tendency is combined with that other, noted in the preceding chapter, toward a rapid transition from financial uncertainty to financial prosperity. The two combine to make the railway a frequent occasion of "conjunctural gains," as the Germans call them.

In part, the railway's accretion of economic rent is due to purely physical causes. Some lines have better natural locations than others. The New York Central Road has an exceptional location in the Mohawk Valley and along the eastern bank of the Hudson. Any railway which first secures the best route along a river valley has an advantage over later competitors in economy of construction and ease of operation.

But an even greater part is played by general social causes.

Population clusters along the line of a railway; towns and industries attach themselves to it. Its traffic increases, while on the whole the expense of conducting the traffic becomes less. Though other railways may be built in such way as to compete with it, the established railway has an advantage which can be lost only by very bad management or very unexpected changes in the course of industry or invention. One great source of advantage is in terminal facilities at the cities. Urban land becomes expensive, and the railway which got its land cheap in the early days has an advantage over competitors who try to enter in later days. It is true that this sort of advantage, like others that rest on social causes, is subject to change and possible decline with shifts in population and with new inventions. The subway method of urban transportation, which has so profoundly affected site values in New York, has also deprived the New York Central Railway of the differential advantage which it formerly possessed from being the only line with a passenger terminal in the heart of the city. None the less, the advantages of an established railway tend in general to increase steadily with the growth of population and industry.

The questions presented by this advance in value are the same as those presented by the same advance in the case of urban sites and agricultural land. The increase has been no more rapid in the railways than in the other cases, and in general has been less striking than that in the value of urban sites. Sometimes it is proposed to tax railways at an especially heavy rate, or to compel them to lower their charges, because their gains are thus tending to rise. It may be desirable to capture some of this unearned increment; but it is not more desirable than to capture other slices of the same sort of unearned increment. The fact that a railway has a "franchise" or is a "public" industry is often urged as a reason for special treatment. But this is to blind ourselves with names. A "franchise" simply means that, under the technicalities of our legal and constitutional system, the process of regulating in-

corporated companies is less fettered than is that of dealing with real property. It does not necessarily bring a substantial economic privilege. Neither is there any help toward getting at the real problem from calling a railway a "public" or "public service' industry. These phrases have little meaning in themselves;[1] they are simply a way of expressing an opinion that a given industry needs some special sort of regulation or restriction. So far as the advancing value of railways is concerned, the question in principle is the same for them as for other site values that tend to rise.

In practise the separation of the unearned increment of railways from the returns reasonably due to investors and for business management is much more difficult than it is with regard to urban sites, or with regard to the municipal monopolies. Extra gains from differential advantages are jumbled with the ordinary returns on investment and with those other extra gains which arise from unified control. Though separable in economic analysis, they are best dealt with by legislation in connection with the general reasons for the public regulation of railway operations.

§ 2. More important in their social consequences are the tendencies toward unified control of railways, — both toward the concentration of control in few hands, and toward the emergence of monopoly through the elimination of competition.

The concentration of control or ownership in few hands has been promoted by the way in which our laws have permitted the organization of corporations and the issue of corporate securities. Loose legislation, and (it must also be admitted) looseness in the prevalent standards of business ethics, have here led to some of the most unwelcome consequences of private ownership.

In strict contemplation of law, a share of stock is a certificate that the stated amount — say $100 a share — has been contributed to the enterprise. In practise, it may or may not mean anything of the kind, at least in the United States. Our

[1] See Chapter 62, § 1.

laws have been so framed that certificates of stock have been handed out with little regard to actual investment. Very commonly they mean nothing but rights to vote, and so to control; with perhaps a hope that at some distant time in the future there will be a dividend. Among the railways especially, a common practise has been, and still is, to issue "blocks" of securities in exchange for a given contribution to the enterprise; say $100 in stock and $100 in bonds — or $200 in nominal value of securities — for every $100 actually put in. "Overcapitalization" of this sort has been a well-nigh universal characteristic of corporate operations in the United States. It has led to bad results, — results bad, however, not so much in the way usually supposed, as in ultimate consequences on the ownership and control of the railways.

Overcapitalization is not in itself a ready road to royal profits. The printing of stocks and bonds is no more a source of riches than is the printing of paper money. If securities which represent no investment, or a less investment than their face value indicates, are none the less income-yielding and profitable, it must be because the enterprises which they represent are profitable. The real cause of gain is either good management or monopoly; the greatest gain comes from a combination of the two. So far as railways or other industries are monopolistic in character, successful overcapitalization — successful, that is, in the pecuniary sense — is the result of high prices, not the cause of high prices. A monopoly will in any case set its prices as high as it can.[1]

To this general statement, as to almost all general statements in economics, some qualification must be attached. It will happen at times that overcapitalization does cause at least a clinging to high prices. The managers of an overcapitalized monopoly may have to face the fact that great blocks of securities are outstanding, very likely issued by their predecessors, and now held by all sorts of investors. They are then loth to let go any slice of its profits. We have seen that

[1] See Book II, Chapter 15, § 6.

often the monopoly principle of maximum net profit is not applied in its full sweep, especially in industries which are potentially subject to public control.[1] Where abnormal returns on the original investment have been made, concessions to public opinion, in the way of lower rates or better facilities, are more likely to come when capitalization has not been inflated.

Whether there has been in fact overcapitalization, and whether it has served to conceal profits unduly high, is often a difficult matter. The typical railway in the United States presents a perplexing case. At the outset the roads were usually overcapitalized. But at the outset, and when first put in operation, they were but half completed. Unlike European railways, they began with a plant and equipment largely provisional and adapted to a scant traffic. Gradually, as the country grew and traffic increased, they were improved by putting some share of earnings into enlargements and betterments. This process continued decade after decade, and was combined with the direct and unmistakeable investment of additional capital, through the issue and sale of more stocks and bonds. What the total investment finally was, and what the relation between outstanding securities and actual investment, became very difficult to say. Careful separation was rarely made on the records between operating expenses and additions to plant.

The case is further complicated by the question of a proper allowance for risk and for skill in management. Some railways have been financially profitable; others not so. Some have gone through a long period of no returns and uncertain prospects; others have earned good returns from the very start,

[1] That the question of capitalization is chiefly one between investors and managers, not one between these various interested persons and the public, is illustrated by two conspicuous cases among the "trusts," — the Standard Oil and the Tobacco combinations. The former is, from the business man's point of view, undercapitalized; the latter is overcapitalized. The former has been managed without manipulation as regards "insiders" on the one hand, the investors and "outside" speculators on the other. The latter has been much manipulated. Both have been highly profitable; both present essentially the *same problems as regards competition, monopoly, prices.*

some on an inflated capitalization. The differences are partly due to general physical and economic causes, partly to varying judgment and skill. The mere fact that a railway has been handsomely profitable is no more a proof of special advantage or monopoly than is the mere fact that a mercantile or manufacturing enterprise has yielded a fortune. In all such cases the quality of the management is an all-important factor.

It is not easy to say whether railways in the United States have, on the whole, been abnormally profitable, and hence whether their overcapitalization has concealed a large element of monopoly profits. Successes have been balanced by failures, eventual large returns by long initial periods of no return at all; while at the same time problems of management have been such as to call for the highest business ability. It may be true, as is commonly maintained in behalf of our railways, that in view of all the risks and all the enterprise and all the skill, the gains from them have not been greater than those secured by the investing classes in industry at large, and in that sense have not been disproportionate to the energy and sacrifice involved.

However this may have been in the past, the case is likely to be different in the future. The stage of development, uncertainty, competition, is largely passed; the era of compact monopoly is impending. It is certainly desirable that careful watch be kept on the further investment of capital and the further issue of securities, and that proper accounting should distinguish additions to plant from operating expenses. The legislation both of the federal government and of the several states aims in that direction. The time has come for safeguarding the public rights, by making it clear just what is the actual investment in the monopolies of the present and future.

It is doubtful whether the whole mechanism of irregular and swollen capitalization was at any time necessary or wise. Why not provide once for all by law that securities shall be issued only to represent what has been invested? It is true

that such a limitation must have been accompanied by a liberal margin as to permissible returns. The risks of investment must be offset by a chance of handsome profit. Railways in the United States never would have been built by private capital (and public enterprise, tried at the outset, proved hopelessly incapable of the tasks of development) if no more than six or eight per cent had been allowed as the maximum return. It is sometimes said that freedom, even recklessness, in the issue of securities was a useful device, in that it enabled the projectors to look forward to returns really tempting, and at the same time concealed these returns from a grudging public. Ten per cent, for example, would not have been sanctioned; but five per cent on a doubled amount of stocks and bonds caused no outcry. Possibly, too, there is a seductive effect on the promoter and investor from the appearance of getting something for nothing. A more simple and straightforward way of dealing with the issue of securities might thus have dampened in some degree the feverish speculation and restless progress of railway development. But a slower pace would have had its advantages also, and, not least, restriction of securities would have saved great complications in the later stages of established monopoly and needed regulation.

§ 3. Certain it is that the unrestricted issue of securities has promoted acquisition of control by the familiar class of railway magnates.

The separation of control from investment (and *pro tanto* ownership) has not usually appeared at the outset. It is often alleged that even at the start the real promoters and managers make no investment of their own and assume no real risks. They are supposed to secure all the needed funds by the sale of bonds to confiding investors, keeping for themselves the stock (issued for nothing), and so reaping profits without ever having shouldered any risks. No doubt they would like to proceed in this way, and sometimes succeed. But usually the matter is not quite so simple. The "insiders" must set the enterprise going, must put in their money and stretch their

credit, take the securities on their own responsibility. Usually they are associated with a banking firm, which exacts its toll for backing and indorsing, and acts as middleman in eventually disposing of the securities. Bankers as well as promoters necessarily assume some of the risks. No doubt the purchasers of the bonds are often deceived; and often they deceive themselves, thinking that a so-called "bond" has a high degree of security, even though a rate of interest is offered which on its face tells of a risk involved. As time goes on, however, with misrepresentation or without, the prior securities, which have the first claim on the profits and involve the least risks, get into the hands of the general investing public, and the shares of stock remain in the hands of the projectors and bankers.

Shares of stock mean ownership and control. In the eye of the law, the holders of bonds are simply creditors, entitled to their interest, and in due time to their principal, but quite without voice in the management. The stockholders are apt to be a shifting and speculative body. The stock itself in the early stages commonly has little prospect of dividend, and is valuable for the time being only because it secures control. It is bought and sold at low figures. It is apt to fluctuate sharply in value because of the abrupt fluctuations in the financial prospects of railways.[1] It is precisely the sort of security that finds favor for speculative purposes on the stock exchanges. The original promoters sell out more or less, as they find the price to be tempting. They are concerned much more with the current quotations of the stock than with the permanent prosecution of the enterprise. The original notion of a joint-stock company — a set of persons associated in a common venture — quite disappears. Each holder tries to get the better of the others by buying cheap and selling dear.

These are the conditions under which the "great operators" appear and under which the vast railway fortunes have been made. Ownership of the stock and control of the railways get into the hands of shrewd, able, daring men. These see the

[1] See the preceding chapter, § 2.

possibilities of future gain when stock quotations are low. Very likely, once in secure control, they will see to it that the properties are efficiently managed, yield large returns to themselves, and even bring better service for the community. But they come into control by the machinery of stock speculation. Such is the explanation of the riches of the Vanderbilts, Goulds, and their fellows. The founders of these fortunes were not the original projectors and promoters of the railways; they are the interlopers who secured control in the later stock-gambling stage.

§ 4. Over and above the great fortunes and the concentrated power over industry, speculative ownership has brought some special evils, of the kind designated by the phrase "inside management."

Perhaps the most striking and serious evil is the corrupt or semicorrupt manipulation of the railways. Those in control may "wreck" it; may make it, in appearance or in reality, a financial failure; may depress the prices of its securities; and then buy up these securities at the low prices. Conversely, they may manipulate the accounts so as to give false indication of financial success, raise the prices of the securities, and sell at high prices to the outsiders; buying in again later when the bubble has burst. A phase of the same sort of thing is when other railroads, or associated enterprises such as bridges, sleeping cars, terminal companies, freight lines, are organized or bought by the insiders, and sold to the main railroad at a handsome profit. Sometimes the persons defrauded by these performances are the investors proper; quite as often they are other stock jobbers and gamblers, ready to do the same thing if they had the wit and the opportunity. The greatest harm from it all is a demoralization of the whole class in the business community which has to do with railway administration.

Still another phase of inside management has been the manipulation of rates for the advantage of the directors and managers; promoted, as has already been said,[1] by the flexi-

[1] See Chapter 60, §§ 6, 7.

bility which attaches in any case to railroad charges. The spirit, good or ill, which animates the leaders, spreads in this case as in others to all parts of the enterprise. Not only directors and influential stockholders, but managers and submanagers, secure their pickings. A whole system easily comes to be honeycombed by corruption.

These evils, all closely connected with the peculiarities of corporate organization in the United States, have been so glaring and cankerous, that the most ardent supporter of private industry must sometimes stop and consider whether even the greatest benefits can offset them. No doubt, it is possible to exaggerate the evils of the situation; and it must be remembered that they have not been peculiar to railways. They have been part of a raw stage of industrial development. Nor have they been all-pervading among the railways themselves. Though hardly one has been without some touch of dishonest manipulation, many have never been deeply tainted with it. Even where the worst has been experienced, the community at large has been mainly responsible. The whole situation has been accepted as a matter of course; partly because the economic and social consequences were not perceived, but in no small degree because moral standards were lax. In both regards, a great change for the better has taken place in the last twenty years. We understand better what speculative railway management entails, and we apply higher standards to business operations in general. The great moral advance of our day has brought a higher sense of social responsibility and solidarity. Practises common not long ago are not tolerated by the present generation.

§ 5. What benefits now have come from all this sullied growth?

No doubt, rapid railway building has been promoted. Under the stimulus of speculative construction and operation, the American community has got its railways earlier and has got more of them. This the community has universally desired, and for this it has been willing to pay handsomely. Our polit-

ical and industrial policy has been dominated by an insensate desire for swift development, for unlocking the land and its resources, for the utmost increase in numbers and wealth. The sober observer may question whether it has all been worth while. A slower growth and a smaller present bulk might have brought a better social structure. But our ideal, such as it was, has been attained.

The march of improvement has been hastened not least among the railways themselves. And it has been hastened, paradoxical as the statement may seem, both by competition and by combination. The bitterness of railway competition has keyed the managers to the highest efficiency in operation; the lessons learned under competition have been applied with striking effect in the ensuing stage of combination. One of the causes of lowered cost of transportation has been the consolidation of the railway net and the growth of the great systems. That process has been facilitated by the ease with which control of railways has been bandied to and fro on the stock exchange. The rapidity with which the vast systems have been created is extraordinary. One great advance came in 1869–1873, when the so-called trunk line systems — the New York Central, Pennsylvania, Erie, Baltimore and Ohio — were formed. The depression of 1873–1879 gave another opportunity, just when the stage of revival was impending, for the creation of the great Southwestern system by the arch-manipulator, Jay Gould. Still another opportunity came during and after the great depression of 1893–1896, which led in a few years to the Hill system in the Northwest, the Union Pacific or Harriman in the Southwest, the Morgan system in the South. The combinations of which these have been the great examples have vastly promoted railway efficiency. The most remarkable achievement of the American railways — an achievement not matched anywhere in the world — has been the cheapening of long-distance transportation; which again has profoundly affected the geographical division of labor, both within the country and in the exchanges with other countries, and has increased the sum total of the industrial output.

Can it be said that the vast fortunes got together in the course of the railway combinations have been earned? that they have been no burden on the community? The pessimistic view is that they rest on mere stockjobbing, combined with monopoly; on swindling and extortion. The optimistic extreme is that on the whole they have been worth while; the community has paid a high price, but it has got great benefits in the way of better transportation.

The classification of this sort of fortune-getting in any scheme of economic analysis is difficult. In part, the fortunes represent the shrewd gathering of monopoly gains and unearned increments. In part they are gamblers' winnings, aided more or less by loaded dice. In part they are the results of extraordinary ability and of the undaunted assumption of great risks. The gains are partly predatory, partly the earnings of highly productive labor; they are both legitimate and illegitimate.

Under a careful system of public control, so devised as to give full encouragement to enterprise and investment and yet prevent illegitimate and excessive gains, it might have been possible to secure the good without the evil. But how to frame such a system is difficult enough at this late date, with all the experience that has gone before; and it is even harder to bring a good plan to public acceptance than to construct it. Historically, the course of development seems to have been controlled by a fated destiny. Given the impossibility of public ownership and management (and for the earlier stages of railway development in this country public operation was out of the question); given the eager desire of the community for ways of transportation, and its willingness to encourage their construction in every way; given the looseness of corporation laws, the universal speculative temper, the laxness of business standards; given the periodic fluctuations in industry, the economic peculiarities of railways, the opportunities for large-scale ventures, — and the harvest was prepared for the daring and able operator. Perhaps all the advantages from

rapid construction, wide permeation of the land with railway facilities, from competition and consolidation and vigorous management, could have been got in some other way; but a train of deep-seated causes seems to have decreed that they should come in just this way and with just these checkered results.

§ 6. The railway situation in the United States has changed much in recent years, and railway problems have taken a new shape. The period of speculative building and promotion has come nearly to its end. Consolidation proceeds apace, even though no longer by the spectacular method of single-handed capture of great systems. Competition is being fast eliminated. The railway problems of the present and future are in greater degree, and in simpler form, phases of the problem of monopoly.

As to its local traffic, a railway always has a virtual monopoly. True, there is the possible substitute of other transportation, say by wagon. But the cheapness of railway transportation is so great that it can supersede other modes of carriage, and yet exact a charge of its own much above a normal rate. Its very ability to carry at low charges drives out competitors, and brings a situation in which its own charges may become unduly high.

Yet competitive traffic, though limited to perhaps a small number of points on the railway net, affects in some degree the whole. Local rates cannot be too flagrantly out of accord with other rates, partly because of public opinion and possible public action, partly because local business will dwindle if disproportionately burdened. So long as railway competition persists,—and it is apt to remain through the early stages of development,—it exercises a check, more or less spasmodic, yet in some degree effective, on the general range of rates.

But as the lines of transportation become established, competition tends to disappear. Pools and rate agreements are made; eventually complete combination ensues. All the factors described in the preceding pages contribute toward it,—

the severity of railroad competition, the economies of large-scale operation, one-man power. Competitive bidding for traffic is superseded by consolidation of the rival lines. Competitive building is superseded by deliberate division of territory. The railway net is rapidly settling down, — not indeed to the stage where no new investment is being made, but to the stage where no new great systems are being formed, and where the traffic is apportioned once for all among the existing systems.

As the stage of monopoly is reached, a railway is tempted to charge what the traffic will bear in the monopoly sense, — quite a different sense from that explained in the preceding chapter. Managed as a private or purely money-making enterprise, it will charge the general range of rates which will bring the maximum profit; subject to all those modifications of the theoretic extremes of monopoly prices to which attention has already been called. On each particular item or class of traffic it will tend to charge what the conditions of demand make possible for that particular kind of traffic. People constantly confuse the principle of joint cost with that of monopoly. To charge what the traffic will bear under the former principle is for the public interest; to charge what it will bear under the latter is against the public interest. So far as monopoly becomes effective, railway rates call the more for public regulation, even though the problem of settling what is a "reasonable" rate in any particular case must remain a very knotty one.

Public control of rates is indispensable under any circumstances, whether the monopoly power of a railway be qualified or absolute. When competition is finally eliminated, that power becomes portentous. If, indeed, it should be very greatly abused, it would speedily bring its own downfall, through the substitution once for all of public ownership for private. But it may be seriously abused without becoming unendurable. In the earlier stage of railway experience in the United States, questions of relative rates, of discrimination, of corrupt rates and favoring shippers, were the most important. In the existing stage of impending monopoly, the question of the

general range of rates has come into the foreground. Not only the power of the railway over this or that industry is to be curbed, but its power over industry at large. Many good persons of conservative bent fail to face this situation squarely. They deceive themselves, as people so commonly do when confronted by a great issue, with question-begging phrases. They admit that railway rates should be "reasonable," and that "unreasonable" rates should be prohibited. Yet they oppose vehemently the grant to any public body of authority to "fix" rates. The difference is only one of words, at most one of method. To prohibit an unreasonable rate is the same thing as to fix a reasonable rate; the process may simply be more slow and ineffective. No doubt, the authority thus given to a commission or court is a far-reaching one, not consistent with the traditions of competitive industry. But, for better or worse, competition has ceased in great branches of industry. So far as it has ceased, public regulation of prices, by direct or indirect methods, is inevitable. That the problem is a peculiarly complex one as to railways is a reason for taking it in hand with great circumspection, but by no means a reason for not grappling with it at all.

CHAPTER 62

Public Ownership and Public Control

§ 1. How far shall public regulation be carried? To the point of ownership and management once for all? These questions, most conspicuously presented by railways, become of greater and greater moment in the modern world, as large-scale operations spread and monopoly conditions impend more and more.

No doubt there are some things which in the advanced countries are by general consent no longer in private hands. Such are highways and bridges, and elementary education. As the sense of the widespread importance of some services becomes stronger, they are conceived as no longer to be dealt with on the *quid pro quo* principle; they are provided gratuitously for every individual, and the means for providing them are raised by taxation.[1] They are then necessarily supplied by general levy and under public management. The doubtful questions are as to those services which are still rendered essentially on the *quid pro quo* principle, as in the case of the post office with its rates for postage, a municipal water service with its water rates, a state railway with its passenger fares and freight charges. These institutions may be in private hands; and if in public hands, they present problems very different from those as to education and ordinary highways. And, to repeat, the question arises, which among them are properly subjects for public management?

The doubtful industries are those commonly designated, especially in this country, as "public service industries," such as railways, the telephone and telegraph, the supply of

[1] Cp. Book VIII, Chapter 66, § 1.

water, gas, electricity. The phrase "public service" is a question-begging one, implying as it does that a clear and simple line of demarcation can be drawn between the operations that are and those that are not appropriate for public management and control. Such industries as have just been mentioned are "public" in two senses. The one is legal, and comparatively easy to define. The other is economic and more important, but more difficult of precise application; it rests on the character of the industries as monopolies.

A railway cannot be built unless there is legislation for acquiring its right of way. Without the right to take land at a valuation, — the right of eminent domain, — it could be blackmailed or blocked by any landowner on its route. A gas company, again, needs the right to dig up the streets, an electric company similar rights to use or cross the streets. A street-car company *ipso facto* uses the public highways. Hence these are in special degree dependent on public authorization, and so subjected with comparative ease to public control.

But it does not follow from this characteristic alone that they should be managed by the public, or even subjected in any special degree to public control. The real reason for treating them as "public service" industries, in the sense that they call for public control, is economic, not legal; and the fundamental economic reason is that they tend to be monopolies. If competition were effective in them, as it is in the supply of boots and clothing and flour, the fact that some use of the highways was necessary, would not be thought to entail public regulation; any more than the fact that the streets are used by cabs and omnibuses, hawkers and street venders, brings these *ipso facto* within the public service class. On the other hand, even though there be no need of specific authorization, no grant of special powers or "franchise," no obvious means of control, any industry which reaches the full-fledged monopoly stage calls for regulation and suggests at least the possibility of public ownership. If flour making or bread making were in the hands of a tight combination, we should soon hear it

dubbed a public service industry. It *is* a public service industry in the sense of being of vast importance for all the public. But it does not call for regulation so long as competition is sufficiently effective in it. Water supply is a public industry in every sense: legislative authorization is indispensable, the industry is supremely important, it has monopoly character.

Though the extent to which combination or monopoly will proceed among modern industries is uncertain, it is clear that it will extend far. That the industries now commonly called "public utilities" belong in the monopoly class, was not at first seen in the United States. Competition was invoked in the early days as the means of regulating their charges. Rival railways, rival street railways and gas companies were welcomed, and the belief was entertained that here, as in other industries, competition would suffice to make charges reasonable. How many American cities have had competing street railways and gas companies and telephone companies, with promises of lower charges and better service; and how infallibly have the competitors in the end got together in a tight combination! Notwithstanding repeated experience of this sort, an illusory hope is still cherished in many cases as to the efficacy of competition. The simple and obvious fact is that monopoly inevitably ensues. The need of regulation in some other way than through competition must be faced once for all.

The cause of monopoly in many of these cases (though not in all) is strictly economic: namely, that the industries are conducted under the conditions of increasing returns. So with the railway; though probably the rate of increase diminishes as the railway system enlarges. When power superseded animals in street-railway traction, the same became true of this industry. Electric light and power, gas and water, all are more cheaply supplied if one unified plant serves a single large area. In such cases the words prophetically used by John Stuart Mill, in the early days of the present industrial régime, are as true as they were sixty years ago: "When a business of real public importance can only be carried on advantageously

upon so large a scale as to render the liberty of competition almost illusory, it is an unthrifty dispensation of the public resources that several costly sets of arrangements should be kept up for the purpose of rendering the community this one service. It is much better to treat it at once as a public function; and if it be not such as government itself could beneficially undertake, it should be made over entire to the company or association which will perform it on the best terms for the public."[1]

The post office and the telephone and telegraph are best managed under monopoly conditions for reasons which in part are different. They are much more useful to the public if all-embracing and singly managed. It is conceivable that letter service should be handled by one set of companies in the cities, and by another set in the country. The rates could be, and probably would be, lower in urban districts, if these were separately supplied; and it may be a question whether the present uniform rate, yielding high profits in the cities, is in accord with current notions as to the equitable relation between cost and price. But the enormous convenience of being able to reach any and every correspondent once for all, at a simple fixed rate, outweighs any possible doubt as to the equity of the uniform rate.[2] To this, of course, must be added, in the case of the post office, the educational and political gains from a uniform rate and an all-inclusive service. In the case of the telephone, the advantage of unified service is

[1] Mill, *Principles of Political Economy*, Book I, Chapter IX, § 4.

[2] The expense of the post office is largely for collecting, handling, sorting. These items are the same for every letter in a given district. Mere transportation costs comparatively little. Hence, a uniform charge, irrespective of distance, is not so far out of accord with cost as at first it seems. This was among the main grounds on which Rowland Hill argued for his great reform (penny postage). In a comparatively small and densely settled country, a uniform postage rate thus rests on an economic as well as on a social basis. In a vast country like the United States, the economic reasons are less strong. Distance and cost of transportation count for more in the expenses, especially where not only letters are carried, but bulky printed and miscellaneous matter. Uniformity of charge, like the extension of free delivery into sparsely settled country districts, can be justified chiefly on larger social grounds.

most conspicuous of all. The essence of effective telephone service is to be able to talk to any and every subscriber. Competing telephones, each having its own set of subscribers, are the height of absurdity. The elimination of competition is here not only inevitable, but unquestionably beneficial. The only possible question is whether there shall be public monopoly, or private monopoly regulated by public authority.

§ 2. In virtually all of these cases, public ownership, where it has been adopted, has been preceded by private; and this for the reason that the spur of profit is necessary for the initiation of advances in the arts.

We are here on disputed ground: how far do the selfish motives predominate, and how far must they be appealed to for the furtherance of material progress? Men are extraordinarily unequal, and not least unequal in the degree to which they respond to altruistic impulses. Among men of genius — great painters, poets, musicians, men of science — the coarser motives are often veiled or overborne. Among them, the inborn instinct is strong; they work not primarily for reward, but because the bent is irresistible. So it is to a large extent with inventors. But these are highly exceptional persons. For the vast majority of men, the argument from the bribe holds. The prospect of gain is immensely powerful in bringing men to exercise their faculties to the utmost pitch. This is the case in no small degree even with those of highest genius. It is more markedly the case as we descend from this very small set to the much larger class of able, though not brilliant, men. For all except the very few of extraordinary gifts, the spur of gain is not only powerful, it is indispensable. Almost all inventors and men of science are subject to the self-regarding motives which affect so profoundly the life about them. They work the more strenuously and effectively in proportion to the expected reward. This is the principle underlying the whole system of patents, copyrights, and trade-marks, nay, the whole system of competitive industry and private property.

Further, for the progress of industry, there ~~must be not only~~

inventors and managers, but persons willing to venture their means in new ways. The history of all the great advances in the arts, especially the epoch-making changes of modern times, shows that the business man and venturesome capitalist have played an essential part. We are apt to think of successful inventions as made once for all at a precise date by one individual. In fact, there has been almost invariably a long period of experiment by many persons, — rival projects and false starts, disappointing trials, slow emergence of the finally successful device. The steam engine, the textile inventions of the industrial revolution, the railway, electric traction, flying machines, all went through this stage of uncertainty. To select among the rival schemes, and to venture boldly on new investments, the business man is as necessary as the inventor. Sometimes, as in the case of Stephenson, Siemens, Edison, the inventor is also a business man. More often — as in the typical case of Boulton and Watt — the two sorts of ability must be combined in a partnership; the inventor needs the backing and guidance of the managing capitalist.

The history of the past shows the spur of profit to have been at work, and apparently indispensable, in all the industries of the sort we are now considering. Private management has been a necessary stage. Public management has come as a transition and a growth, not by an independent start. Where indeed an industry has been developed by private activity in one country, it may be transplanted to another without the preliminary stage. When the railway, after a long period of experiment, had been brought into effective working order in England, it was easy to introduce it on the Continent as a state industry.[1] A generation later, it was easy for the Australian colonies to undertake public management of railways, by importing from England men trained in the school of private

[1] Most railways on the Continent, none the less, were built, and at the outset managed, by private companies. The first construction was usually undertaken by English contractors, among whom the Stephensons and Brassey were conspicuous. In the United States, the railway grew independently, and throughout by private enterprise.

management. Electric traction for urban transportation was easily started in England as a public business, after private enterprise in the United States had shown how the thing could be done.

The probabilities are that the same course will be followed in the future. The present state of water-power transmission through electricity supplies an instructive illustration. Here are great possibilities, nay, great certainties. The simple matter of building dams and impounding the water can indeed be done by the state. But the hydraulic and electric plant, and the transmission and distribution of the power, involve risks and call for enterprise and vigor (not to mention technical progress) such as public officials are not likely to supply. The utilization of water power through electricity thus waits on private initiative and management. Obviously, a monopoly situation exists, or at all events impends; there is just so much power, and he who controls it controls all the industrial possibilities. The public should never give away in perpetuity the ownership of this great resource. Yet it can probably secure its effective development only by allowing scope for private profit. Only at a later stage, when the best ways of utilizing the power have come to be understood, may public management take the place of private.

§ 3. When the transition from private ownership and management takes place, the question of vested rights will always arise. The terms of purchase must not be such as to deter future investment in other enterprises. But, on the other hand, only so much should be paid as is necessary to keep alive the spirit of private management and investment. The bribe should not be larger than suffices. Naturally, the recipient tries to get more, — unlimited franchise at the start, and at the later stage purchase at the top price. The financial markets will capitalize his earnings, whatever their range, and he will expect purchase at the capitalized value.

It is the first and simplest canon of public policy in these matters that there should be no unlimited franchises. Whether

the question be of railways or street railways or gas works or telephones or water power, the right to establish and conduct the industry in private hands, and the needed authorization from the law, should be for a limited term. There should be, too, a reserved privilege of purchase at terms based on the cost of the plant, not on the capitalized value of its earnings. Experience shows that a period of thirty years, certainly one of fifty years, is long enough, and that a right of purchase on reasonable terms does not deter private investment.

In this respect, our American communities have been reckless of posterity. They have sold their birthright for a song, or have simply given it away. The explanation is obvious enough. In the pioneer days, one of the main objects of the early settlers is to possess themselves of the very things that will become valuable in the future, — land, urban sites, mines, forests, water power, "franchises." No one then thinks of conserving the rights of posterity; nearly every one wishes to appropriate at once those things for which posterity may pay a large price. Only a stringent prohibition, by constitutional enactment or from an outside power (Congress as to the Territories), will keep a pioneer community from such appropriation of the possibilities of the future.

When the mistake has been made of allowing the monopoly industry to get into unrestricted private ownership, and where it has been sold and bought by successive persons on the basis of such ownership, there is nothing to do, if the transition to public ownership is determined on, except to buy the owners out at the market price. The purchase price must then be fixed, not on the basis of cost of investment or reproduction, but on that of the capitalized value of the earnings. The case is the same as with land and urban sites. If the community has sanctioned investment and purchase on the basis of a perpetual franchise, it must itself buy, as it has authorized others to do, on the basis of present value. At the most, it can conserve for itself only the future increase in the earnings of the monopoly or privilege; just as it may appropriate through

taxation the future increase in the value of urban sites. Unless all private property is wiped away once for all, the lawful owners of this particular kind of property cannot be singled out for special dispossession. Hence, for example, when Prussia in 1878 resolved on the epoch-making step of buying the railways for the state, purchase proceeded frankly and even liberally on the basis of the market value of the roads. Great Britain will do the same when she buys her railways, as she may before very long. The United States will have to do the same, if the time should come for that far-reaching change. France is in a comparatively favorable position for the possibilities of the future; since, under the terms of the original legislation, her railways are to pass into the state's hands by the middle of the twentieth century (1959), without any compensation at all for the permanent plant.

§ 4. The preceding discussion has proceeded as if the transition from private ownership to public were certain to come in the case of all the monopoly industries, and as if it were dependent solely on the attainment of a settled stage of technical and industrial development. But the matter is not so simple. Public ownership may not come at all; or it may be preceded by a long period of private ownership under public regulation. The conditions on which the choice of policy must depend are here not economic in the narrower sense; they are mainly social and political.

There have been, it is true, attempts to formulate certain economic characteristics by which the line between public and private industry can be drawn. A well-known older attempt was that of Jevons, who stated the earmarks of an industry adapted for public management to be the following: (1) small capital account; (2) routine operations; (3) the coördination of several services, as the post, the telegraph, and the telephone; (4) the sufficiency of a single all-embracing plant, as in the case of water and gas supply. This enumeration, made at the time when the transfer of the telegraph to the state was under discussion in England, has obviously failed to fit later exigencies.

The very first requirement, that of a small capital account, is not met in the case of the railway; yet here we have public management on a great scale. None the less, the enumeration still deserves attention; for it points to some of the political difficulties of the problem.

Underlying the requirements of Jevons is a suspicion of public officials. This explains the very first requirement, — small capital account. Where the capital account is large, the financial and technical outcome of an enterprise is difficult to judge. The management may be good, yet expenditures for repairs or enlargement may result in a deficit in the year's account. Conversely, a skimping on needed repairs and on improvements for the plant may enable a good showing to be made by a poor manager. Every person who has looked into the accounts of a railway or ironworks or large manufacturing concern knows how necessary it is to analyze the figures, and, above all, the state of the capital account, before judging whether the management has been good. To supervise public officials, and to judge whether their administration has been efficient, becomes the more difficult as plant is larger and more complex. The more one is disposed to entertain general doubt as to the probable success of public officials, the more is one averse to intrusting such business to their hands.

Something of the same sort holds of a routine character of the operations. This also makes supervision easier. Where administration can be reduced to set rules, it is easily seen whether these have been followed. For the same reason it is sometimes said (as it was by Jevons) that an industry is more likely to be well conducted by the state if its operations are constantly under every one's eye. The post office fulfills all such requirements; indeed, this case doubtless suggested the criterion. If we start with the premise that public officials are to be mistrusted, and must be constantly under watch, we end with limitations on state management such as Jevons suggested.

Now the question whether public officials need to be constantly watched depends on their character and quality; and this, again, in a democracy depends ultimately on the character and quality of the electorate or other body that chooses them. If we are sure of the probity and ability of the officials, we may turn over to them for management a very wide range of industrial operations. We need not hesitate because the capital account is large, or because the operations are irregular and complex, or are concealed from the public eye. We may intrust to them the management of all the monopoly industries which have passed the formative and experimental stage, and in which the technical conditions have become fairly settled.

To sum up: the strictly economic earmarks for state-managed industries are maturity and monopoly. But the state means state officials; and whether these are competent to take charge is a troublesome political and social problem.

§ 5. Two things are necessary for the securement of an efficient body of public servants: first, well-devised political institutions; and second, — above all in a democracy, — a sufficiently high level of intelligence and character in the great mass of the community.

Not a little depends on tradition and habit. The spoils system is largely a bad habit. Until it is rooted out, good public management is hopeless. The bureaucracy of Germany has the support of ancient traditions, bound up with devotion to the monarchical ideal. It has proved an invaluable instrument for the successful extension of state activity. Our American principle of checks and balances, of limited power and divided responsibilities, works against efficient public management. Our principle has been inherited from the days when the would-be absolutist was at the head of the state, and when state officials were suspected of attacks on liberty. We are slowly coming to recognize that the state is a great agent for social uplift, and that its officials need more freedom of action, less fetters on action. In municipal government, where the situation is worst, the goal of reformers is the elimina-

tion of the wheels within wheels, concentration of responsibility, diminution of the number of elective officers and lengthening of their terms, permanent tenure for the routine staff and for the trained experts. In all these respects, habits of thought are slowly changing, and the way is being prepared for at least the possibilities of better things.

The employment of public laborers in a democracy is always a thorny problem. They strive to become a favored class, with extra pay and extra privileges. As has already been said,[1] other laborers are apt to support them in such endeavors, from a confused notion that the process will raise wages and privileges generally. Elected officials, on the other hand, are apt to accede to their demands; for this compact body of voters needs to be conciliated. At its worst, the employment of large bodies of laborers means a political machine and political corruption. Even at its best, it is likely to bring place-making and easy stints; hence, inefficiency and expense.

Private industry has a quasi-automatic check to this evil. The manager looks to money-making, and will pay to labor no more than he can get it for; that is, no more than other labor secures. The public official, on the other hand, is not rigorously subject to the test of profits; he can dip into the apparently bottomless public purse. The state should be a model employer, and should set an example of good wages, moderate hours, steady employment, humane surroundings. But the state should also set an example of requiring for its full day's pay a full day's work. The ideal of too many people is that it should be generous with the pay, but easy-going with the work. There is a world of significance in the Australian phrase, — "the government stroke." A public official in a democracy always finds it difficult to exercise the power of discharge, above all to prevent conduct that is simply slack and dilatory.

The maintenance of progress in the arts is another difficult matter under public management. Technical maturity is

[1] See Book V, Chapter 47, § 1.

never reached completely; further advance is always possible. There is indeed a wide difference between the early stage of uncertainty and experiment, and the later stage of gradual improvement on established lines. The railway, for example, is still being made more efficient; but the great lines of technical and economic procedure seem to have been definitively marked out. Though the application of electricity to traction may bring great changes in railway transportation, there will be none so revolutionary as those in the early period of invention and development. Nevertheless, in railways as in other industries, even when they have reached a comparatively settled stage, public management, to be fully satisfactory, should not be content with doing passably well what the world has already learned to do. The continued progress which it should maintain calls for keenness, vigor, enthusiasm, single-minded devotion to professional tasks on the part of trained administrators and experts. Only an intelligent and self-restrained democracy, or a very capable autocracy, can enlist such men and get them to do their work in the best spirit. The German Empire and the German states, in their post office, telegraph and telephone, perhaps in their railways, unmistakably in their military organization, have maintained a high spirit of ambition and emulation. But the Australian colonies seem to have secured simply humdrum management; honest, to be sure (and for this much we in the United States, to our shame, must pay our tribute of respect), but devoid of life and vigor. No democratic community, with the possible exception of Switzerland, has shown in its public industry a spirit of progress comparable to that of private industry.

§ 6. In the end, all these matters of organization and efficiency go back in a democracy to the most fundamental of the requisites for successful public management, — the moral and intellectual quality of the community. There must be in the community a good average of character and conduct, in order to secure even honesty and faithfulness; there must be, in addition, a good average of intelligence and self-restraint, in

order to select and retain a body of trained and progressive experts. It is hard enough to secure the first of these things; it is very hard to secure the second.

We in the United States have still to learn how to get common honesty and faithful routine. Antiquated political institutions, excess of elected officials, lack of concentrated responsibility, — all these explain a good deal, and improvement in these matters of political machinery promises a good deal. But at bottom we have to depend on the stuff of the people. A good electorate will choose honest and capable officials, a debased or indifferent one will tolerate demagogs and thieves. The traditional method of committee administration and scattered responsibility has often been held accountable for the evils of municipal government in the United States. No doubt it has had ill effects. But it is striking that a very similar system in Great Britain has not stood in the way of honest and efficient administration.[1] Reform in the machinery of municipal government will avail little unless the right persons are chosen to run the machinery. From this elemental requisite there is no escape.

It is often said that corruption in our municipal and state affairs is caused by private ownership of the great monopoly enterprises, and that public ownership is the cure. To reason so is to mistake the occasion for the cause. The occasion is the great fund of gain which the monopoly enterprises can yield; the cause is political demoralization. It matters little whether the initiative in corrupt ways is taken by the heads of the monopoly corporations or by the public officials, — whether the first step be bribery or blackmail. In either case it is the existence of venal legislators and administrators that brings coarse and characterless persons into the management of the "public service" industries. Honorable men withdraw from the unsavory affairs and are replaced by those less squeamish. The root of the difficulty is that a bad political situation in-

[1] See Lowell, *Government of England*, Vol. II, Chapters 39, 40, esp. p. 179; and Munro, *The Government of European Cities*, 282 *seq.*, esp. p. 307.

vites corruption, not that corruption makes the political situation bad.

On the other hand, this much must be admitted; there is a certain kindling power in public action. The sentiment of a community can be aroused toward accomplishing well the tasks which it has set for itself. It is absurd to go so far as to say that there is an automatic effect on the quality of government from giving government much to do, — that the mere assumption of larger tasks will make the body politic fit for accomplishing them. But pride can be enlisted, especially local pride, and some stir may thereby be given to smoldering forces for good.

§ 7. It is not too much to say that the future of democracy will depend on its success in dealing with the problems of public ownership and regulation. To allow the great monopoly industries to remain without control in private hands is to allow an *imperium in imperio*, — nothing less than a plutocracy. To manage them as public enterprises, or to regulate them effectively while still in private hands, calls for restraint, abdication of the town-meeting method, intelligence in choosing good leaders, steadfastness in following them. These things are not learned in a day, nor is there any certainty that the mere increase of public industrial management will cause them to be learned. It may be that we in America shall not reach for a long time the stage when we shall be able really to grapple with the tasks of public management. The ideal solution is that the great monopoly industries should be under efficient and progressive public management; but he is sanguine who believes that the attainment of this ideal will come easily or quickly.

To admit that a task is difficult, the outcome uncertain, is not to say that it should be given up. The experiment of public ownership and operation should be tried, and every effort made to bring it to a successful issue. The most promising field would seem to be the municipality of moderate size. To put vast industries now into the charge of city governments

like those of New York or Philadelphia would be reckless. But cities of smaller size may have better possibilities. Even though, in these also, the political conditions too often have been wretched, the movement for "municipalization" has better prospects, and a trial is to be welcomed. If it fails, it will show that those are mistaken who would make haste in adding to the undertakings of democracy. If it succeeds, so much the better.

Success or failure in such experiments cannot be gauged in a short time, nor without reasonable discrimination. Mistakes and disappointments will be inevitable in the early stages. A considerable period must elapse before it can be known whether the needful lessons will be learned. And, as to the final outcome, it must be remembered that the question will be always one of the balance of gain. The opponents of public ownership are constantly pointing to its weaknesses and its ugly aspects, — slowness and indecision in adopting improvements, placation of the public by concessions that make a show on the surface (*e.g.* low passenger rates and good passenger accommodations on railways, to the neglect of the more important freight service), logrolling, undue favors to employees. The real question is not whether these things are bad, but whether they are worse than the evils of private ownership. He who compares, for example, the railways of the United States and Australia will undoubtedly find some serious defects in Australia. But he will find crying evils in the United States. He will find greater efficiency in our own country, but also tortuous management, and ominous consequences in the greater inequality of wealth; and he will not render an unhesitating verdict against the state railways of Australia.

The business and well-to-do classes of all countries, and especially of English-speaking countries, rarely consider this subject with an open mind. They listen readily to all the evidence that tells against public ownership, and are pessimistic as to its prospects. The persons now in control of the money-making monopolies supply them freely with all sorts of dis-

torted information and superficial arguments. In the United States more than anywhere else, their prejudices are rank. This attitude is due to various causes. In part, it is an inheritance from the older political philosophy of *laissez-faire* and noninterference. In part, it is due to sad experience of misgovernment in this country. But to no small degree it arises from a lurking fear of dispossession. Public management is "socialistic"; it is feared as the entering wedge to complete expropriation.

The relation of the problems of public ownership to socialism will be considered elsewhere.[1] But this much may be said at once: private property is more likely to maintain itself if it is coupled with an extension of public regulation. It will be more secure if its abuses are done away with, and if the avoidable causes of great inequalities are removed. Public ownership of the monopoly industries, or the alternative of public regulation, may be called conservative in the sense of possibly obviating changes really revolutionary.

§ 8. The clear alternative, then, and the only alternative, to public management is public regulation. Ideally, regulation is less good, but practically it may be much better. Reasonably successful regulation is more easy to attain than reasonably successful public management.

Some matters of political machinery need attention in this case, as in that of direct management. The success of regulation depends on the quality of the individuals who are to regulate. They should have stable tenure of office and adequate salaries. They should be chosen not by popular election, but by executive appointment. These are simple requisites, too often neglected in our American states. But the problem of finding and retaining good men on regulating boards or commissions is vastly easier than that of finding and retaining men capable of efficient management.

Two distinct types of board or commission have appeared in American experience: the commission for investigation and

[1] See Chapter 64, § 4.

recommendation, relying chiefly on publicity; and that with power of command. The first type, of which the Massachusetts railroad commission was the earliest and the best-known example, was commended for a long time by the sober American observers. None the less, the second type has gradually come to prevail. Investigation and publicity can do a great deal, but not everything that is needed. The milder form of regulation was a natural first step, when people were still timorous about state interference. As they have become used to it, and as the growth of monopoly has appeared more clearly to call for regulation, commissions of the second more drastic type have been generally established. In Massachusetts itself, the authority of the railroad commission has been gradually extended beyond investigation and recommendation; and the later commissions of this state, such as that on gas and electricity, have been given large powers on the crucial question of the prices to be charged.

Mere publicity, no doubt, can accomplish much. Things reprobated by current standards of morality will be done in the dark when they will not be done in the open. The fear of further regulation, too, strengthens the disposition to submit to public opinion. Of this a striking illustration appeared in some investigations of the United States Bureau of Corporations on railway rates in 1906. It was shown that sundry railways had given favoring rates to the Standard Oil Company, in ways which, according to their own contention and that of the Oil Company, were not contrary to law. Probably some of the rates were, in fact, illegal; others were not against the letter of the law. But, whether lawful or not, all these devices were swept away by the railways themselves immediately on the publication of the Bureau's exposure of them.[1] Mere publicity sufficed,—sufficed, largely because it was clear that the public temper was aroused and that something more than publicity was in the background.

[1] See the concise statement in the Report of the Bureau of Corporations for 1910, pp. 1-2; compare the remarks of Commissioner Smith, reported in the Proceedings of the Chicago Trust Conference.

Publicity is important also for the protection of investors against unscrupulous managers. To the well-to-do, regulation in the interest of investors means regulation in behalf of that "public" with which they are chiefly concerned. No doubt, this is an important matter, and of no small social consequence. Regular and detailed reports in approved form, subject to verification by public accountants, will do something to check the evils of stockjobbing management. But these are matters in which the main reliance must still be on the traditions of good conduct among the well-to-do, and on the ordinary machinery of the law. In any case, they are not the things which mainly concern the general public.

The essential object of publicity is to bring about results that shall be advantageous for the whole community. Of this simple truth, the matter of capitalization supplies the clearest example. Information upon capitalization is wanted because it is indispensable for the inquiry into prices and profits. Until we know what is the relation between the outstanding securities of a public service corporation and the "physical value" of its property, we cannot know whether its profits have been really excessive. No doubt, "physical value," of which so much is heard at the present time (1910), is less susceptible of exact measurement than many people suppose. Even if it be defined (as in general it should be) in terms of what it would now cost to reproduce a given outfit, the estimates of experts and engineers will be found to differ largely. Figures of cost or value such as are often published, refined to the last dollar and the last cent, give a misleading impression of rigorous accuracy. But they are none the less useful; for they show whether there has been a gross and palpable difference between capitalization and investment. This is the main thing in which the public is interested. In all such matters a certain margin must be allowed. If private industry is permitted at all, it must not be held down by a cheese-paring policy. But it must also not be permitted to conceal, under swollen capitalizations, gains that beyond question are unreasonably high.

All the modes of regulation, whether by supervision, publicity, or unqualified command, look to the same end: control of prices and of profits. Sooner or later such control is likely to be undertaken directly as well as indirectly. People of conservative temper smell confiscation in it; yet it is all involved in those first steps of investigation and publicity which they commonly approve. Reforms of this sort proceed by stages which follow the slow growth of public opinion, the meaning and probable outcome being concealed at the outset by ambiguous words and mild measures.

Direct control may be of prices or of profits, or of both. Like the control of capitalization, it should have a reasonably liberal regard to the returns of investors and managers, and must content itself with results satisfactory on the whole. Prices seem on the whole easier to regulate than profits. Restriction of profits, *i.e.* of dividends, may be evaded by extravagant salaries and bonuses. Even when not so evaded, it removes the stimulus to efficiency and progress. Prices, it is true, are not so easily fixed at a "reasonable" point as is a rate of dividend on capital. Some knowledge of cost of production and of technical details is called for. In such industries as that of railway transportation, there are peculiar difficulties, already pointed out.[1] The need of a trained body of permanent public officials is obvious. But the fact that their task is difficult, and that only an approximation to an ideal solution is attainable, is no reason why the task should not be undertaken at all. All the truths of economics are approximations, and all its ideals can be attained only in the rough.

Not the least of the things which public regulation should try to accomplish is the elevation of the standards of private management. The speculative promoter, the stockjobber, the unscrupulous corrupter, should be crowded out, and the business leader of the better type brought in. To this end publicity will do much; and pressure will do much, too. Let it be made a paying policy to have honest and farsighted manage-

[1] See Chapter 60, §§ 3–6.

ment, content with moderate but sustained profits, and considerate in its dealings with the community. There are able business men in plenty to whom management of this sort appeals. There is no harm in mixed motives, and some mixture of public spirit and private interest is a remedy worth trying. The now-pervading conviction that these are not strictly private industries, and that the persons in charge of them have duties to the community as well as to the investors, leads to a very different attitude from that common a generation ago. The public is no longer damned. Pressure through publicity and through threat of legislation or forfeiture of charters, plans for direct public ownership, demagogs' attacks, if you please, — all strengthen the better attitude Let it be made worth while to please the public.

This sort of halfway result — supervision and regulation, prices such as to yield tempting but not extravagant profits, some pretense and some reality of public-spirited management by money-making corporations—is intolerable to many ardent persons. It seems to them Pecksniffian, or, at the best, patronizing and patriarchal. And in truth it probably stands for only a halfway stage. So far as the trend toward mononoly proves irresistible, so far the movement toward public ownership will gather impetus. It is likely to proceed further and further, and will cover a widening sweep of industries. It will reach not only municipal industries, but national ones also. It is the crucial problem of democracy; and, to repeat, on success in dealing with it, more than on anything else, depends the future of democracy.

Unwieldy though the federal government is, permeated by the vice of conflicting sectional interests and legislative logrolling, it may soon extend the activities of the post office so as to include a parcels post; and indeed this step is desirable for the immediate future. Though the outlook for success in the telegraph and telephone is now but poor, the assumption of this industry is not unthinkable. That of railway management seems now out of the question; yet who can say what political

and industrial transformations may come in the course of another generation or two? The present century before its close may see changes undreamt of in the philosophy of the bourgeoisie.

For the present, however, and as far in the future as we can see, the main task before democracy in America is that of making more simple and smooth-working its political machinery; of securing plain honesty and routine efficiency in the accepted functions of government; and of regulating with some tolerable success the industries of the monopoly type. When good results in these comparatively simple problems have been achieved, it will be time to turn to the larger and more complex problem of public industry on a greatly extended scale.

CHAPTER 63

Combinations and Trusts

§ 1. Attempts at combination and monopoly are as old as industry. In European countries, during the earlier stages of their economic development, such attempts were subject to prohibition and penalty. During the modern period, the trend has been, until very recent years, to let them take care of themselves, competition being relied on to keep prices at a fair or normal level. In English-speaking countries it has hitherto been supposed sufficient simply to prevent the enforcement of agreements for combination. Under our common law, contracts in restraint of trade are void. They are not *per se* punishable; but they cannot be enforced in the courts. Just what constitutes a contract in restraint of trade, such as the courts will hold void, has been the occasion of nice legal discrimination. Some agreements which restrict competition are adjudged to be "reasonable," and the parties to them will be held to their contracts. Others are adjudged to be "unreasonable," and will not be enforced. The line of distinction is in principle clear enough: those agreements are bad which tend to bring a range of prices higher than that ensuing under free competition.

It is astonishing how effective this simple policy of indifference has been. Combinations, pools, and price agreements among manufacturers and dealers have been among the most common phenomena of modern industry. Almost invariably (unless bolstered up by some independent cause conducive to monopoly control) they have gone to pieces of themselves. The persons forming them have been both shortsighted and covetous. It has often been the case that all would have made larger gains if all had stuck to their restrictive agreements.

But each has been desirous of increasing his own particular gains, and each has been suspicious of his associates. The usual result has been that price combinations are no sooner made than broken, with much lament that there is so little honor among these quasi-thieves. Even where the would-be monopolists have held together for a while, competition from outside has soon caused their compact to crumble away. Usually the outside competitors also have been covetous and shortsighted, failing to see that their own entrance into the field tended to destroy the very gains in which they were trying to share. The truth is that few men, in business or in other doings, look beyond the present and immediate future. Had they a more resolute and intelligent eye to ultimate results, the policy of letting people try at monopoly, but refusing legal sanction to their monopolistic agreements, would have proved much less effective.

But in our own day the situation is changing fast, at least in many directions. Far-reaching plans and ultimate results play a greater and greater part in industry. Still more important is the fact that, as large-scale production spreads, the number of individual establishments diminishes, and the entrance of new competitors grows increasingly difficult. The attempts at combination become more persistent and ingenious, and the efficacy of a policy of non-interference becomes more uncertain.

§ 2. First among the modern endeavors in the United States to prevent the disintegration of nonenforceable agreements and so secure a tight combination, was the trust device, which gave to the term "trust" a new meaning now embodied in familiar usage. Large-scale operations being commonly conducted under corporate organization, it was arranged that the holders of stock in the several companies to be combined should all transfer their shares to a few selected persons as trustees; these trustees then holding the shares, and having the rights of vote and control which belong to titular shareholders, but being under obligation to manage the property for the benefit of their

cestuis (to use the legal phrase) and to turn over to these all dividends and profits. Thus the scattered owners and their enterprises would be tied irrevocably to the combination, and the trustees, as nominal stockholders, would control everything in their own hands; while at the same time the summary control over trustees by courts of equity would prevent overreaching of the owners by these trustees. It was an ingenious device, but, as it proved, one to which the courts refused to give the expected legal solidity. In a test case it was held that the ordinary machinery of the law would not be used to carry out a scheme in effect monopolistic; and it was held further that a corporation which practically divested itself in such fashion of its independence was subject to dissolution. This particular method of securing tight combination was accordingly given up in the industries in which it was tried. The only permanent outcome was that the word "trust" came to be attached in popular parlance to any and every sort of combination, and, indeed, to any and every sort of large-scale operation.[1]

The holding company formed the next stage, and indeed is still the prevalent stage in the United States. A corporation is formed which acquires the stocks of the several combining concerns, — either all of the shares, or enough to give control. Its directors thus become the effective managers, just as the trustees under the trust scheme were designed to be. The original corporations retain their existence, and nominally continue to do business as before; but all control is united in one board. This device, nowadays so familiar, has the advantage, for the would-be monopolists, of achieving the result and at the same time concealing it. It may easily be made to appear that no combination at all has been affected. It has other tactical advantages, too; there are wheels within wheels,

[1] This "trust" device was first used by the Standard Oil combination. The Sugar Refiners tried it later, and it was in their case that the courts refused to apply the law as had been calculated by the astute lawyers who had framed the scheme. These enterprises, and the others that tried it, have all turned to other forms of combination.

holding corporations for the original holding corporation, and thus not only further concealment, but easy possibility of manipulation by a small knot of insiders. These same results are in the main disadvantageous from the public point of view; they bring obscurity, mendacity, stockjobbing, danger of corruption. There is a strong disposition to put a check on the holding company device, which can easily be done by prohibiting a corporation from being the shareholder of another corporation.[1]

The last stage, and the one to which the others lead, is simply that of the great or giant corporation, into which all the former competing enterprises are formally and completely merged. The holding corporation tends to develop into this, its constituent (or subordinate) parts being deprived of their nominal independence, and the shareholders becoming direct shareholders in the single company. For some time the indications were that the attainment of this final stage of combination would be accelerated by the very endeavors of our law to suppress combination. Under the prohibitory statute of 1890 (the so-called Sherman Act), a holding company might be unlawful, and subject to dissolution, on the simple ground that it obviously stifled competition between the subordinate corporations held together by it. Whether the completely unified corporation, made up *de novo* from the others that completely disappear as corporations, stifles competition, and hence becomes subject to the prohibitions of the statute, is a question much less easy to decide; since it involves inquiry as to the relations between the consolidated company and its "outside" rivals. As will appear in the course of this chapter, it is often difficult to make out whether such a company attains a monopoly,

[1] This power — to hold the stock of another corporation — never belongs to a corporation under English and American law, unless given in express terms by the grant of its charter from the sovereign power. In the absence of express grant, such holding is *ultra vires*. Our American states have been so complaisantly liberal in their laws as to incorporation, and have so frequently given the power, that most people are unaware of its being dependent on specific authorisation, and do not know how easy it is — given only the will — to check this form of combination.

even whether it strives to attain one; still more difficult to decide what is wise policy in dealing with such a real or would-be monopoly. Yet these problems will have to be faced before long both by the judges and by the legislators; for the holding company is likely to be succeeded by the form, less vulnerable before the law as it now stands, of complete consolidation.

In Germany, and on the continent of Europe in general, a different state of the law has caused combinations to take a different form. There contracts in restraint of trade are not void; they are enforced as between the parties; but they may lead to penalization if deemed by the courts reprehensible or inconsistent with the public interest. The interpretation of these general principles has been the subject of as much nicety in judicial construction as has been the English common-law principle with regard to restraint of trade. Broadly speaking, however, their outcome has been plain. Ordinary agreements for pooling, fixing prices, and the like, which are not enforceable in the countries of English law, are enforceable on the Continent.[1] The parties having once come to an agreement must abide by it. Hence they are not prompted to those devices for higher combination which play so large a part in our American development. The German *Kartell* is commonly an elaborate organization, public and formal, which fixes prices and prevents the members from competing with each other. In its typical form, it includes a central sale agency, to which orders go, and by which sales and prices are effected; and, not less important, it provides for a limitation and apportionment of output, each member being assigned a specified amount (or proportion of a total) within which he must confine his product. The *Kartell* leaves to the individual members a greater degree of independence than any of the American forms, — the trust or the holding company or the unified corporation; since each member manages his establishment in his own way. It is disputable

[1] See the excellent article by Dr. F. Walker, "The Law Concerning Monopolistic Combinations in Central Europe," *Political Science Quarterly*, Vol. XX, p. 13 (March, 1905).

whether the German method does or does not lead to technical improvements more than does the American, — whether the spur which each German producer still has in cheapened production outweighs the advantage from large-scale consolidated management on the American plan. Nor is it clear whether the German *Kartell* is a mere transitional stage, likely to be followed in time by complete consolidation. There is no such pressure from the German law toward forming an all-embracing giant monopoly; and the course of economic development has been slower and more tentative.

The form which combination may take is obviously less important than the fact of combination. The essential question is whether the conditions of competition are, in effect, supplanted by those of monopoly. Combination does not necessarily mean monopoly; it may mean only a regulation or modification of competition. But the object of those who plan it is to stifle competition in some degree, and to secure greater gains than competition will permit. In the United States, a new goal of business ambition appeared in the latter part of the nineteenth century (more specifically, in the decade 1880–1890): business leaders began to scheme for full monopoly, not only in the industries of unified plant, but in ordinary manufacturing industries. The Standard Oil enterprise was the first conspicuous instance; the Sugar Refining concern was another. Both proved financially successful to a marvelous degree. Toward the close of the century a veritable rush for similar combination took place over a great range of industries. At the same period in Germany the *Kartell* of the coal mines proved stable, increased the profits of the mine owners, and served to raise in even greater degree the quotations for shares in their companies. Here, too, a conspicuously successful case led to a rapid spread of combination. The trust problem suddenly appeared full-fledged.

§ 3. Two different questions present themselves. One relates to the permanency of the combination or trust: whether it will have advantages in methods of production which will

enable it to hold its own and bring financial gain to its promoters. The other is concerned with its effects on the public: whether it brings advantages for the organization of industry toward the general good. These two sorts of possible advantage we may consider in order.

The permanency of a combination, or its success in the business man's sense, depends partly on the real economies which it makes possible, partly on some tactical advantages or so-called "unfair" advantages.

The real economies of combinations are chiefly those of large-scale production, and have been already considered.[1] They vary from industry to industry, and, within a given industry, vary from time to time with the progress of invention. No general rule can be laid down regarding them. Only the test of competition and experience can decide whether an establishment produces more and more cheaply as it grows larger and larger. The special question presented in this regard by the trust movement seems to be whether a combination of establishments, each one of which is large enough to secure the utmost mechanical efficiency, can yet be so managed as to produce more economically than the several establishments when independent; in other words, whether large-scale management adds something to the gains from large-scale production in the narrower sense. Here, too, it would appear at first sight that the matter may be allowed to settle itself. Let them fight it out, and let that form of organization survive which does the work most cheaply.

The question arises, however, whether the "unfair" advantages of a great combination may not enable it to overcome rivals, even though these can produce as cheaply and serve the public as well. May not the great producer secure tactical advantages from mere size, mere length of purse, mere pressure through influence and threat and manipulation, which will enable him to destroy his smaller yet equally serviceable rival?

[1] See Book I, Chapter 4, § 4.

One tactical advantage, much referred to in the debates on this topic, has arisen from preferential rates, in the way of rebates and the like, on our American railways. The notorious special rates secured by the Standard Oil Company were of great aid in enabling that combination to crush or absorb its rivals, especially in its earlier stages. Other great combinations enjoyed similar favors, and, like the Standard concern, threatened to become masters of the railways. Though one great cause which led to this evil in former days — the peculiar pressure to which a railway is subjected when competing with rivals — has been weakened by growing consolidation among the railways themselves, another source of similar danger has come from the widespread dominance of the persons who engineer the trusts. The concentration in the control of great industrial, banking, and transportation enterprises has threatened an interrelation of "interests" and a moneyed oligarchy over great stretches of the industrial field.

None the less, the influence of this factor in promoting and maintaining trusts has probably been exaggerated. Special rates were part of the general chaos of railway rates in the earlier period. They resulted from large-scale operations, and in turn promoted large-scale operations; and it was this general development, inherent in modern conditions, which led to the general movement for industrial combination. The evil of railway preferences has been immensely diminished, almost wiped out, by the penalties imposed in the interstate commerce act of 1887 and the later measures of the same sort, by the consolidation of the railway net, and by the growing sense of public responsibility in railway management. Yet the industrial combinations have remained, even though, like the railways themselves, they have turned to less intriguing and irregular methods of operation. And it would seem certain that, notwithstanding the slow and halting progress of public regulation, and notwithstanding the many ways of concealing an advantage under outward forms of equal railway rates, this cause of advantage for the browbeating combination will cease to be of importance in the future.

Other devices of combinations for getting competitors out of the way are more direct. Simplest of all is cutthroat competition *ad hoc*,—sales at prices ruinously low, designed to force the rival into bankruptcy or absorption. Mere length of purse, without possession of any real advantages in efficiency, may bring victory in this sort of warfare. A similar method of crushing a competitor, more insidious and effective, is through partial reduction of prices, designed to oust him from his particular field. Thus a combination which manufactures a variety of articles may cut the price of a single one, in order to bankrupt a rival who produces that one; the combination maintaining prices on its other articles, and thus offsetting in part or entirely its loss on the contested one. This result is also secured if the combination can discriminate in prices on one and the same article, lowering the price where there is competition, but maintaining it elsewhere.

All such devices were again and again illustrated in the history of the Standard Oil Company, the archetype of the industrial trust. In its sales of illuminating oil, — which was the main product, — its method, carried out with remarkable skill, was to sell to retail dealers only. In the phrase of the mercantile community, it did its own jobbing. In regions where there was competition from other refiners, it cut prices ruthlessly. But it kept prices up in other regions where there was no competition, and so maintained its own profits. This policy would have been difficult to carry out had it sold to jobbing wholesalers, since these not only compete with each other over widely extended markets, but know of each other's doings and buy and sell among themselves. Each retailer, on the other hand, covers a limited region only; he does not compete with distant retailers, or concern himself about the prices at which they buy and sell. Obviously, some geographical limitation on its competitors was also essential to the successful working of this device; the competitors must have been kept from reaching the retail market at all points, either by transportation rates higher than those granted to the Standard, or by the isolated location of their refineries.

Still another device is the factor's agreement, so-called, — a contract with a dealer (wholesale or retail), by which he agrees to sell only goods produced by the combination. If the combination has a "line" of goods which are established in public favor, the dealer feels that he must have them. If many dealers are coerced or cajoled into buying these, and these only, a rival producer on a smaller scale finds great difficulty in marketing his more limited set of goods.

A possible influence of the same sort appears in advertising. Mere effrontery in puffing your wares is an important factor in modern trade. The advertising problem is a curious one. It is not easy to say just how far advertising serves a good purpose, how far it means waste. No doubt, it does stimulate wants, introduces new devices, promotes variety in production and consumption; and it is often a means of useful competition. But sometimes it is a weapon of destructive competition. Among articles equally good, that which is systematically paraded is likely to be most readily sold. People are led to buy Smith's wares rather than Jones's. One might suppose that if Smith's wares were equally good, and were sold at a lower price (made possible by eliminating the advertising expense), he would hold his own in spite of Jones's preposterous puffing. But, in fact, Jones's wares are preferred; some vague impression of superiority is produced by the incessant boasting. Plentiful cash is the *sine qua non* of an effective advertising campaign. The large producer, or would-be monopolist, has here again a tactical advantage.

The same is true of other devices for popularizing your goods, — prizes, premiums, gifts, pictures, what not. These delude the purchaser into the belief that he is getting something for nothing. Like mendacious advertising, they rest on the gullibility of mankind, and are effective in proportion as they are carried out on a large scale. The Tobacco combination in the United States has practiced the arts of advertising and of premium-giving systematically and successfully; success being promoted by the fact that for its commodities goodwill and the brand are of special importance.

It has been proposed to deal with some of these tactical devices by legislation. Intentional cutthroat competition — the lowering of prices for the express purpose of driving out a rival — is to be made unlawful. It is to be made cause either for a civil action for damages by the threatened competitor, or for criminal prosecution, or both. Discrimination in prices is also to be made unlawful. A producer is to be compelled, under penalty of civil or criminal law, to sell at the same prices to all applicants and in all markets. He is to be dealt with as the law now deals with common carriers, who are under obligations to do business for everybody on the same terms. Neither cutthroat competition nor discriminating prices are now under the ban of the law in English-speaking countries. They are not punishable, or cause for civil suit, under the common law, nor usually under statutes. Underlying this state of the law, is the belief in the efficacy and usefulness of unfettered competition. The public good is supposed to be promoted by allowing every competitor to press every other as bitterly as he chooses. But the question fairly arises whether we must not admit that here, as in other directions, competition, on the plane and within the bounds hitherto traditional, fails to work for the general good.

The case is plausible for such changes in the law. Unless one is a convinced socialist, and believes that monopoly is simply a welcome forward step toward the eventual assumption of all industrial management by the state, every measure that aids in maintaining "fair" or normal competition is good. It may be that the situation is hopeless, and that, over a wide and widening range of industries, nothing can stay the march of combination and monopoly. But at least let all be done that can be done toward checking the ominous tendency.

Not too much, however, should be expected from legislation of this kind. There are those who believe that, unless there be other causes leading to monopoly, changes in the law as to competition will suffice to prevent that control of industry and that eventual rise of prices at which exterminating com-

petition aims. But unless "fair" competition is strengthened by economic forces, — by industrial conditions enabling the independent producer to hold his own, — little is likely to be gained from this method of staving off the growth of monopoly.

Such legislation is, in its nature, difficult to enforce. What is cutthroat competition? Mere lowering of prices is the ordinary salutary result of competition. Intention to wipe out a competitor, the only thing which the law can make cause for action, is necessarily difficult to prove. Cost of production, fair price, deviations in market prices, — these cannot be settled with the precision necessary in legal procedure. They are necessarily notions of some vagueness. A prohibition of a factor's agreement, again, is easily evaded. It is only necessary to abstain quietly from dealing with the trader who on his part persists in dealing with the would-be monopolist's competitors. A suit at law based on a remodeled law of "fair" competition would be a very uncertain defense against monopolistic aggression.

The effective defense is found only when Greek meets Greek, — when the big monopoly meets with a big competitor. All the devices of "unfair" competition are devices of the large producer and the long purse. One whose purse is equally long will endure cutthroat competition equally well; will meet discrimination with discrimination, will make his own factors' agreements. Large producers will be able to compete, even though the law of competition remains unchanged. The real question is whether competition among large producers will be permanently maintained.

§ 4. With regard to the permanency of competition between large-scale producers, two conflicting forces or tendencies meet; and it is not easily foreseen which will prevail. On the one hand, the competitors are likely to cease fighting and to combine. Where the growth of large-scale operations reduces the number of individual establishments to a dozen or so, they are almost sure to get together sooner or later. On the other hand, the rapid increase of savings and of surplus for in-

vestment causes an incessant search for profitable openings. At the same time, the supply of managing ability is constantly enlarged and varied with the rise of fresh generations of capable business men. New capital and new ability will be turned to every industry that offers large profits; and so long as this is the case, monopoly gains will not be all-pervading, but confined to a comparatively limited range.

There can be no question of the possibility, nay the probability, of some sort of agreement among the large-scale producers. These things go very much by tradition and habit; and the former individualistic traditions are broken among the capitalists themselves as well as among the social philosophers. The notion of getting together and ceasing from competition is becoming a familiar one, and is thrusting aside the older feeling of pride in independent management. It is extraordinary how far the experiments in combination have been carried; not only to those industries where but a very few large establishments — a dozen or so — are left in the field, but to those where the number is thirty, fifty, even a hundred. It is true that the larger the number, the more difficult it is to form an effective trust, and the more probable it is that competitors will remain or will reappear. It would be difficult to say within what limits the movement is confined by the technical conditions themselves.

One special obstacle in the way of getting capital to embark on a large scale in competition with the great combinations has arisen from the consolidation of banking operations and the concatenation of these with the trusts and *Kartells*. New investments on a large scale are hardly possible without being "financed." The financial leaders are often in a tacit understanding not to get in each other's way. In Germany, where the consolidation of banking has proceeded farther than in the other countries, each one of the great banking institutions has under its wing a set of industrial ventures. A newcomer finds it difficult to get the opening wedge of a banker's backing. Something of the same sort is true in the United States also.

But it is not probable that this obstacle to newly competing enterprises will be permanent. The constantly accumulating savings must find an outlet somewhere, and no combination can prevent new banking firms from arising, with new financial and industrial leaders, who will try to break into the jealously guarded preserves.

Among the forces which are likely to give a new start to competition, we must reckon not only the unceasing accumulation of capital and the ambition of new business men, but the possibility of decay in the management of the combination itself. A successful combination is commonly brought about by uniting in one organization the largest and best-managed enterprises in a given industry; the lesser establishments being bought up or "frozen out." Initial success is due to the ability and prestige of the leaders. As time goes on, new leaders must be found. But nepotism is likely to appear in the established management. Competition, which had brought the original managers to the fore, no longer acts to bring about in the combination itself the survival of the fittest. True, goodwill and prestige go a long way, and it is easier to hold a position of command than to attain it. But the economies of large-scale management, as well as the tricks of "unfair" competition, can be learned by others; the stimulus of ambition is most powerful among those who have their fortunes to make; and any settled enterprise — be it a trust, a bank, a newspaper — is in danger of dry-rot.

Whether or no, as the outcome of these contending forces, combinations and trusts will prove to hold their own permanently, it seems certain that in the ordinary manufacturing industries, even in those where large-scale operations prevail, nothing but a precarious and limited monopoly can result. The trust must be always on its mettle, always on the watch against interlopers. These may be browbeaten or bought up; but new ones will constantly appear if the profits are very high. The trust may become a dominant form of organization, and, by good management, may maintain itself permanently

without bringing about true monopoly prices or extraordinary profits.

There is therefore the possibility — perhaps the most hopeful for the immediate future — of a tempered sort of combination, under farseeing management and with some sense of responsibility to the public. The guiding spirits may wisely conclude that competitors must be faced, and that it is good policy to keep profits within limits that will not tempt newcomers. Such is the outcome expected from "potential competition": unified control, a stable course of industry, but prices and profits not greatly different from what would result in the long run under competition. Very likely the profits of the commanding corporation would be liberal, but dependent, after all, chiefly on sustained good management.

Such a turn for the better in the combination movement may be promoted by public regulation, — of this more presently; but much will depend, also, on the state of mind of the business men and the well-to-do class. Though these still worship the money-maker, that same pervasive movement for promoting the common interest which has so profoundly affected social legislation and economic thought is beginning to make its impression on their ambitions and ideals also. More is heard of fair profits and fair prices, legitimate methods, honest gains, a "reasonable" regard for the public, — phrases used in a vague and question-begging way, but none the less significant of a tempered attitude. The monopolist is not a popular person. Even though he shelter himself in the company of those to whom money is the sole test of distinction, he feels the sting of general reprobation. This change in public feeling works in favor of that sort of management which is both moderate and farsighted, is perhaps a matter of shrewd expediency as well as of higher spirit, but at all events promotes the general interest.

§ 5. What now are the possible advantages of combinations for the community?

The only one seriously worth considering is the avoidance or mitigation of fluctuations in industry.[1] The irregularities of

production and employment are among the black sides of the existing régime. The removal of chaotic competition can perhaps do something to check them. It is argued that, as a great ship can hold its course, regardless of wind and wave, so a great combination can disregard financial disturbances and carry on its operations continuously.

The possibility exists; but much depends on the trend of development in the combination movement.[1] It is quite conceivable that it may intensify rather than mitigate fluctuations. A gambling promoter and a patched-up combination; an attempt to raise prices and profits; plenty of watered stock, with speculation and manipulation; the rise of competitors; a sudden puncturing of the inflated enterprise and a collapse on the stock market, followed by a period of uncertainty and reorganization, — these are familiar episodes of recent times. They do not make for economic steadiness. Perhaps they are but transitory and will cease as the limits of combinations are better gauged by the investing and business public. There may be a development of farsighted management and stable combination, and therewith the lessening both of speculative and of industrial irregularity. The United States Steel Corporation, during the last few years (1904–1909), has attempted to moderate the fluctuations in an industry which has been peculiarly subject to them, and, it must be admitted, with some promising results. It is true, also, that among the railways, the process of consolidation has checked the former alternations from feverish new construction to complete standstill. Real gains for the community would come if industrial growth could be made to take place more systematically and continuously.

Another supposed gain from combinations, in some ways allied to that just considered, is in the elimination of the sup-

[1] Professor Liefmann, perhaps the best-informed German investigator of the general subject, believes that the *Kartells* in Germany have not as yet led to greater stability in industry. The American trusts, in his opinion, have accomplished more in this direction; but the achievement, even though greater, is slight. See his *Kartelle und Trusts* (1910), pp. 129, 150.

posed ruinous effects of competition. Under modern conditions, it is said, competition is maintained to the last ditch. When a great plant is once going, it will be kept going so long as anything at all over operating expenses is earned. Railway competition best illustrates this sort of extremity (though accentuated by the peculiar conditions of railway transportation). But any industry having large fixed capital is in a similar case. From all of which it is concluded that unchecked competition will inevitably be carried to the point of general disaster and that combination is the sole means of salvation.

The argument has some foundation; but it cannot be carried far. No doubt, there is an analogy between the capitalist producer who has a going concern with large plant, and the unorganized laborer. Both have to face a tendency to competitive undercutting of standard prices. Neither can wait without loss. Just as the laborer's working power goes to waste if not used, so the capitalist's plant and overhead organization bring a definitive loss when they are idle. Hence, a wholesaler or "jobber" can play off one producer against another, and nibble away at "fair" prices. Hence, too, the disintegrating influence of competition on the minor conditions of the bargains. There is disguised price cutting by manipulation of discounts, by allowances for packing and freight charges, by easy interpretation of what are damaged goods, by accepting remittances in local checks instead of in standard funds. Similar disguised cutting of the standard rate takes place when laborers are overcharged for tools and materials (in the case of miners, for example), or are called on to work overtime without extra pay, or to submit to manipulation of piecework rates. The analogy must not be pressed too far. The capitalists are not so likely to suffer seriously as the laborers, nor is their bargaining so much weakened by the lack of standardized definitions. Yet some analogy there is. In both cases there is a chance for the purchaser to play off one seller against the other, and in both there are causes which justify permanent organization for combined action.

But this is far from saying that a tight and exclusive combination is necessary to protect the sellers, whether capitalists or laborers. An organization for standardizing competition is a very different thing from one for eliminating competition. Yet many persons of the business class talk nowadays as if competition were definitively ruinous to producers, and as if there were no escape from disaster except through the trust or *Kartell.* Competition does not go on automatically, or irrespective of the ultimate outcome. The troubles of capitalists from "excessive" competition will bring in time their own cure. People will not continue indefinitely to invest in industries whose profits are wiped out by cutthroat underbidding. The real source of difficulty for the capitalists, not clearly perceived by those who say that modern competition of necessity works disaster, is the constant pressure of new accumulations for investment, and the constant tendency to a decline of profits in known and established industries. From this pressure the business and investing public is always trying to escape, partly by the wholesome process of improvement, invention, and the opening of new fields, partly by the noxious one of combination and monopoly.[1]

The real evils to the body politic from "ruinous" competition, and the real gains which combinations may bring, are of the sort mentioned a moment ago: they bear on the steadiness of industry. Competition does tend to alternations between feverish activity and dull depression. Combination may conceivably mitigate fluctuations. If it does so, without bringing a tyrannous monopoly, — if the peace and order be not those of despotism, — a gain of no mean social import will have been achieved. But, to repeat, it is by no means certain that this desirable outcome will be reached; and in any case it is a very different one in its public aspects from that preservation of profits through the elimination of competition which the business and investing classes are disposed to welcome.

[1] Compare with what was said on this topic in Book V, Chapter 41, on Overproduction and Overinvestment.

§ 6. In this state of uncertainty concerning some essential elements in the problem, — such as the gain in efficiency from large-scale management, the potency of unfair competition, the mitigation of cyclical fluctuations, — there is inevitably a lack of agreement concerning appropriate legislation. The underlying question of all is disputed: shall there be acceptance and regulation (or at least expectation of regulation), as in Germany, or stern repression, as in the United States? Even if the latter policy be considered settled, troublesome questions arise concerning the method of applying it, and the incidental practices which may be permitted or regulated. For the time being, something like a Fabian policy is alone practicable.

None the less, in developing a legislative policy such as the United States are committed to, resting on the suppression of monopoly and the enforced maintenance of competition, some things are tolerably clear. Legislation may begin on certain lines, the results of experience being awaited before proceeding further.

First among the constituent parts of a tentative policy of repression is the definitive establishment of federal control. Large-scale command of industry can be met only by large-scale legislation. The Bureau of Corporations, established in 1903, was but a beginning. Greater powers than those of mere investigation and report are necessary; a scope analogous to that of the Interstate Commerce Commission.

The most obvious thing to be secured by a strengthened Bureau or Commission is greater publicity, through regular reports, with supervision of books and records by public accountants. Though publicity is in great part a matter between investors on the one hand and promoters and managers on the other, and so far not of the first concern to the general public, it is none the less of much importance to the public; for there is need of information on which to base legislation. We know too little about the extent to which combination has brought monopoly conditions, and know even less about the likelihood of its bringing them in the future.

Publicity will promote that better sort of management which has just been referred to, — management more honest toward investors, more farsighted in competition, more moderate as regards prices and profits. How far a turn for the better will come in these matters, how far private industry will become tinctured with some sense of public responsibility, remains to be seen. But effective publicity will aid in turning the course of development in this better direction.

Another object of control should be capitalization. Here, too, the interest of the public is an indirect one; capitalization is primarily a matter between investors and promoters. So far as the public is concerned, overcapitalization is not a source of monopoly profits, but only a device for concealing them. Its regulation rests, therefore, in the main on the same grounds as the general requirement of publicity. It can perhaps be supervised with effect only by incorporation under federal law. So long as the matter is left to fifty-odd legislatures, there will inevitably be some complaisant or indifferent states which will virtually nullify a watchful and restrictive procedure among the majority. Federal incorporation will seem to many persons a drastic step. But however unwelcome centralized control of this kind may be, it must be admitted among the possibilities of the future.

One immediate and important phase of the control of combinations is the "holding company." It may be going too far to prohibit at once any corporation from holding the shares of another. But, at the least, full information should be had as to these interrelated companies. The wheels within wheels are often but devices for concealing the real situation, or for easy retention of control by a few insiders. Genuine publicity will be secured, and effective regulation made possible, only if the whole story is put on public record.

The various forms of "unfair" competition call for attention: perhaps mere definition, perhaps regulation, perhaps stern inhibition. This is a thorny matter, as has already been indicated. The common law on unfair competition may need to be

revised; yet this part of the legal situation seems to be itself in a state of flux and uncertainty. It is not clear that amendatory legislation is called for, still less clear what shape the new enactment, if needed, should take.

Control of profits and prices is a more drastic step, and one not often formally proposed. It is obvious enough that this is the thing ultimately aimed at. As in the case of the public service industries, the essential thing is the effect on the distribution of wealth. Publicity, supervision of capitalization, regulation of competition, all look to this main end. Perhaps comparatively mild measures will suffice to prevent "undue" profits and "unreasonable" prices. But if the mere suppression of overt combination fails to achieve the desired end, control of profits and prices must be resorted to. It may be direct regulation of rates, like that of the Interstate Commerce Commission on railroads. It may take the form of regulation of profits through taxation of excessive gains. In either form it will be difficult enough, necessarily entailing a stringent supervision of accounts. But the open-eyed watcher of industrial changes must face it as a possible measure of last resort.

§ 7. One troublesome problem will present itself at the very beginning of any attempt at systematic legislation: how define the thing to be regulated? What, in the eye of the law, shall constitute a combination or monopoly or trust? The law cannot use rough and approximate conclusions or statements, such as often suffice for the economist. It must define in precise terms. What are the earmarks of a monopolistic combination?

Mere size is not conclusive. A concern may be of huge extent, as to capital and output, and yet may not control the output in such manner as to bring to itself monopoly returns. Nor is possession of the field a conclusive indication. In current discussions it is sometimes assumed that when a "trust" produces 50 or 60 or 70 per cent of the output in a given industry, it is virtually in absolute control. This by no means follows. The trust may have vigorous competitors, or may be under

farsighted ("conservative") management with a view to staving off such competitors.

A more certain test would seem to be found in large profits, on a scale much beyond those to be expected under competitive conditions. Yet here too caution is needed. Large profits, of 20 and 30 per cent on capital and more, are constantly secured in industries subject to unfettered competition; sometimes under the influence of a favorable turn in the market, more often because of high managing ability. None the less, long-continued high profits, on a great scale and spread over a large capital, are suspicious. Thirty per cent on a capital of a hundred thousand dollars may not be an unusual return for a man of ability; but the same rate of return on a capital of a million, still more on a capital of ten millions or a hundred millions, cannot be steadily secured under competitive conditions.

Again, discrimination in prices constitutes, as we have seen, a symptom of monopoly: yet here also only if long continued and on a considerable scale.[1] Some discriminations arise naturally from competition and the higgling of the market, from the endeavor to stave off the consequences of an oversupply, from the wish to introduce goods in a new market without "spoiling" the accustomed price in the old. It is only where one set of buyers are continuously charged prices substantially higher than are charged to others, that we smell monopoly.

The strictly economic indications, however, are not easily applied in legislation. I suspect that, certainly as a first step, the law must go by the mere fact of size. All large concerns — large in terms of capital or of output — may be compelled to conform at least to the requirement for report of the simplest facts, such as capital, output, and profits. Such information, continuously secured for a series of years, will serve as the basis for further inquiry and, very likely, for further legislation.

§ 8. The American policy of repression was long a flat failure. For some fifteen years after the passage of the Sherman Act of 1890 the effect of all the prohibition and penalizing

[1] Cp. Book II, Chapter 15, §§ 4–5.

was *nil*. Not only did old combinations go on undisturbed, but in the closing years of the nineteenth century there was that extraordinary outburst of new combinations to which reference has already been made. The great combinations were not even driven into hiding. The business world went on with its experiments and contests regardless of the law of the land.

Within a surprisingly short period, however, the situation changed. An unmistakable public opinion against trust "extortions" — partly such in reality, often exaggerated, — and still more against the spectacular emergence of vast fortunes, not justified under any of the accepted economic canons, led the successive administrations of Roosevelt, Taft, and Wilson to vie with each other in more and more drastic applications of the law. A large number of combinations, among them conspicuously the oil and tobacco trusts, were haled into court and compelled to disband. Others took the same course rather than meet prosecution. The policy of trying to crush monopoly was resolutely put into effect.

None the less, few thoughtful persons believed that this alone sufficed as a permanent policy. Not only those who held combination in some form and under some restriction to be the more advantageous organization of industry, but also those who were intent on rigid suppression, looked to further legislation, less vague than that of 1890, and with better administrative machinery for enforcing its provisions. Accordingly two important acts were passed in 1914. One, the so-called anti-trust act, repeated the prohibitions of the act of 1890, and added further provisions designed to prevent holding companies, so-called interlocking directorates, and other devices for concealed combination. The second, more novel and more important, established a Federal Trade Commission, with large powers of investigation and supervision. Much discretion was given the Commission. For example, it might call for reports — *i.e.* secure what may be called a "round-up" of the enterprises to be supervised — on any principle or to any extent it saw fit. On the vexed question of unfair competition it was also given

wide discretion. No attempt was made to define what was unfair; the Commission was simply given power of quasi-judicial inquiry and of issuing orders, with appeal to the courts in case the orders should be disputed. As in the analogous case of railways, the establishment of the Commission marked the beginning of a new era: a settled policy of control, but no hard and fast settlement of the precise methods by which control was to be exercised.

To one group of thinkers, the socialists, the conclusions of this chapter will seem not only uncertain, but childishly uncertain; and legislation like that just described will seem a feeble palliative for a deep-rooted disease. To view the progress of industry as has here been done is, the socialists say, to see the trees but not the forest. The large outstanding fact is the collapse of competitive industry. Combination and monopoly are the inevitable result of the machine processes and of large-scale production. Legislation cannot prevent monopoly, nor can it prevent its concomitant of ever growing inequality. The bourgeois economist only palters with the situation when he weighs the pros and cons of competition and combination. The bourgeois legislator, whether he tries to repress or to regulate combination, is trifling with a force that is irresistible. The evolution of industry necessarily brings full-fledged monopoly. The ultimate outcome is already plain: the state will expropriate the monopolists and will manage all large-scale industry for itself. Socialism is the one goal and the one gospel; it is the desirable and the inevitable end. To this problem we turn in the chapters that follow.

CHAPTER 64

SOCIALISM

§ 1. Socialism proposes to do away with the system of private property, and especially with that system so far as it leads to great inequalities. It proposes, above all, to do away with the leisure class, and with incomes from interest or rent, — to allow only incomes secured by labor.

In the first half of the nineteenth century, schemes for small-scale socialism were rife. They contemplated select communities, oases in the competitive desert. There men, having left the selfish life, should share things in common, without strife or victories or privileges. Such communities have been established in many countries, most frequently in the United States, where the spirit of freedom and non-interference, if it has led to great lengths of individualism, has at least permitted men to experiment freely with communism. Usually the societies or associations which have tried these experiments have been communistic in the narrower sense; that is, all things have been shared in common, and all members have been on one level in respect of income. But such complete leveling is not an essential feature. It is quite conceivable, and not inconsistent with the ideals of the societies, that leaders should be distinguished not only by their position of leadership, but in some degree by their income as well. Usually, too, the societies have had a religious basis. But this, also is not an essential characteristic; some have been frankly unreligious. It is true that those infused with a religious spirit have lasted longest, and have been most successful both in worldly and in spiritual ways. As a rule, the experiments have collapsed, after a comparatively short period of trial; yet a few, under leaders of commanding personality and fervid religious spirit, have had

long and interesting careers. Harmony, the Shakers, the Oneida community, the Amana Society, — these are some noted cases in the United States.

But the history of the small communities counts for little in the modern socialist movement. Like most things of to-day, socialism looks not to petty experiments, but to large-scale operations. It proposes a complete transformation of all society. Machinery and huge industrial enterprises, the minute division of labor, the use of great plant, transportation and exchange on a great scale, — these are to continue; but all under public management. No corner of society is to be left untouched by the process of transformation.

This transformation is to be economic only; or, at least, accompanied by other changes only so far as they may result inevitably from those of an economic sort. It is true that many socialists advocate changes in other great social institutions also, — in religion, in the family, in political organization; and to some among them such changes seem as essential as changes strictly economic. Yet there is diversity of opinion on these matters; and the socialist ideal does not necessarily lead to any one policy regarding them. It is conceivable that the socialist state should concern itself not at all with religion, as little as does the state in our American society. Equally possible and consistent would be support to different denominations, such as that given by German states. Probably the majority among the unqualified socialists are frankly unreligious; but some deeply religious persons, devoutly attached to existing churches, are frankly socialistic. At the least, complete tolerance of all forms of worship and belief would seem to be unquestionable in the transformed society. Again, in the family and the institution of marriage, no great outward change seems to be necessarily implied. Some socialists believe in a looser connection between the sexes than that of marriage for life; but there is no reason why their society should not maintain the present relation. The responsibilities of parents to children, it is true, would inevitably be different from what they now are,

— of this more will be said in the next following chapter. But marriage, the family, the home, might be expected to remain very much as they now are. Nor is any particular form of political organization essential. Here, to be sure, there is a greater approach to unanimity among the socialists than on some other points. To most of them their economic program seems the legitimate and inevitable outcome of democracy. Yet one of the keenest among the socialists, Rodbertus, looked to the permanent maintenance of a monarchical form of government; and one of the greatest of philosophers, Comte, who sketched an ideal organization virtually socialistic, believed that it must have an autocratic head.

Lastly, socialism does not necessarily imply revolution or violence. Most well-to-do people of the half-educated sort associate it with the red flag and a reign of terror; just as most of them find no epithet of condemnation so conclusive as "socialistic." It is true that the most influential socialist thinker of modern times, Marx, was frankly a revolutionist. He believed that the existing régime could not be abolished without violence, and his preaching was inflammatory. But other socialist thinkers, no less ardent, look to a peaceful change; some to a rapid one, even though peaceful; some to a slow evolution that will lead to the transformed society by gradual orderly steps. Marx's own followers, though loyal to his general teaching, are now much less truculent than was Marx himself. The most thoughtful and kindly disposed among the socialists — and brotherly love, rather than envy, underlies the movement — look not even to any hasty dispossession of the present property-holding classes. These might be pensioned in some way, — assured of their present income, or at all events of a very comfortable income for themselves during life and even for their children. The indefinite continuance of a set of persons who are (from the socialist point of view) mere drones is indeed inconsistent with socialist principles; but the process of getting rid of them may be a gradual and peaceful one, entailing no serious suffering for any individual.

§ 2. The essential end which socialism tries to attain is a change in distribution. By way of attaining this, and primarily in order to attain it, the machinery of production is to be made over. More accurately stated, the machinery of production is to be turned over to other hands, — transferred from its present owners into the ownership and management of the state. All land, all factories, workshops, railways, all the instruments of production, are to be public property. All the advantage which such things bring, in the way of increasing the productiveness of labor and the output of industry, are to go to the community as a whole. No part of the advantage is to be got, as now, by private owners.

This does not mean that all ownership of property shall disappear. It is sometimes said that socialism must fail because it runs counter to a deep-rooted instinct of ownership and property, showing itself from the child's grasping of its toy to the avarice of the aged. The socialists reply that, whether or no there be such an ineradicable instinct, ownership is not to disappear. One may have one's own clothes, furniture and books and household possessions, may save one's own money, perhaps even possess a house. Only such forms of consumer's wealth as may readily give rise to an "unearned" income are to be kept out of private hands. The ownership of dwellings, to be let at a rental by one person to others, could not be permitted; for this spells inequality and a possible privileged class. But it would not be out of the question that a person should possess a house of his own, bought with savings; as one might own a piano or a horse. These things might also be transmitted by inheritance to children. Only ownership of *investments* of any kind, and dealings with things as investments to yield an income, would seem necessarily tabooed, — no contracts of lease allowed, or payments of rent or interest. The details of a utopian community have an attraction for many people, who amuse themselves by specifying just how dwellings might be owned and inherited, how turned back to the state at a valuation if the possessor wished to make a change, how let

by the state as universal landlord. So one might speculate on the extent to which sale or hire of other durable consumer's goods might be permitted,—furniture or pianos. The things essential in regard to the ownership of property in the socialist state are that, so far as it is in private hands at all, it shall be susceptible of wide diffusion, shall not give rise to anything in the way of "funded" income, and shall not be cumulative.

A curious change has taken place recently in the attitude of many socialists in regard to land. The unrelenting socialist, classing land as obviously an instrument of production, would leave it all in the community's hands and would have all gains from it guarded for the community. But there is sign of some withdrawal from this extreme position. The change is due, especially in Germany, to the impossibility of rousing even an interest in socialism, not to mention adherence to it, among the millions of small land proprietors. Each owner clings to his few acres; and the socialists are beginning to consider whether there is any reason why he should not be allowed to. Private ownership of agricultural land, where it is in the hands of those who themselves till it, gives rise to no great inequalities and to no considerable unearned gains. On the other hand, concentration not only of ownership but of management in the hands of the state suggests problems difficult in proportion to the difficulty of great-scale farming. Why not let the small and moderate farm owners ("peasant proprietors") stay as they are? This would mean quantitatively a large breach in the strict socialist doctrine, but qualitatively nothing to be much regretted. The tenure of the farmers might be that of leaseholders on long term, with fixed rentals; and the state would surely reserve the right to take possession of the site if it should become unusually valuable (*e.g.* through the discovery of mines). Urban land, mines, manufacturing sites, would in no case be let out of the community's hands. Where large-scale agricultural operations proved necessary, they might be undertaken on some sort of coöperative plan. Here, too, there is a temptation to speculate on possible details, and to work out a utopia

to one's own satisfaction. Agricultural land presents problems of its own in existing society, and would do so in any socialist organization. Yet it may be doubted whether it would prove possible to retain the essentials of private property and management here, after they had been swept away elsewhere.

Distribution in the socialist state would be in one way very simple. Wages would be the only form of income. Rent and interest would disappear. There would doubtless be pensioners and paupers, but no leisure class, — no set of able-bodied persons living in prosperous idleness. Business profits would exist only in a strictly limited form, as wages of management. A carping critic might say that the rent of land could not really be done away with, since it results necessarily from the inherent differences between natural resources. The socialists would have to admit that in this sense a rent — a differential return to some sorts of labor and effort — would remain. But the private appropriation of rent would cease. The excess of return on the better sites would in some form or other go to the community.

Exchange would proceed in the socialist state very much as it does now. Exchange is part of the machinery of production, and that is not to be disturbed. There would be warehouses and shops, constant passage of goods from factory to counter, daily purchase of goods by consumers. All middlemen and all shopkeepers (virtually all, — might there be exceptions for some hucksters?) would be "business men" in the employ of the state and receiving its wages. There would be money, too; presumably metallic money, because this is clean and durable. The devisers of utopias have sometimes pictured something else, — labor tickets, quite different from the traditional sorts of money. Things for sale in the shops might be labeled with the amounts of labor which their production had involved, — all the labor, remote and near, direct and indirect. Each producer would receive tickets in proportion to the amount of the labor he had performed, and would use these tickets as money Thus each person would buy the prod-

uct of precisely as much labor as he had himself performed. Such an arrangement assumes an apportionment of wages on a strict labor or sacrifice basis. Of this aspect of the case, more will be said presently; certainly the determination of the prices of goods would necessarily involve a principle of distribution among the wage receivers. But labor tickets and the like fanciful devices signify nothing. The essential things would be to have stable prices and stable money incomes, — no rise or fall in the value of money, no problems of appreciation or depreciation, no crises, no dislocation of the machinery of exchange. The quantity of the circulating medium would be adjusted to the quantities of things bought and sold, and to a given scale of prices for them; in a manner analogous to the present adjustment of the quantity of subsidiary coin to the occasions for its use. The prices of things would *not* adjust themselves, as now, to the quantity of the circulating medium. This medium we may suppose to be bright, clean ıld and silver and copper, — or any one of them. But the .ining of these metals as well as the manufacture of the coins would be government operations.

§ 3. The crucial question of distribution — in fact, the only question of distribution in a socialist state — would be that of wages. On what basis is the pay of different sorts of workers to be fixed? There are three conceivable principles of apportionment: need, sacrifice, efficiency.

Distribution according to need would be the simplest of all; for it would mean that all shared alike. It is true that men's capacities for enjoyment are different, and their needs correspondingly different. Some are sensitive by nature; to such, plain fare and cheerless surroundings will always be more distressing than to the average man, and ampler means will be a greater source of pleasure. And apart from differences in sensitiveness, he who works with his brains doubtless needs, for full efficiency, better surroundings and greater variety in occupation than the manual worker. But considerations like these could not seriously affect the general consequence

that distribution according to needs would lead to virtual equality. The seeming diversities in the keenness of desire and enjoyment are due chiefly to habituation. Those bred to comfort and refinement are sensitive because they have been made so. The socialist state could pay no attention to such differences. And though it might logically pay attention to other differences not due to the established habits of far-separated social classes, — to differences between weak and strong, between sensitive and coarse persons, — the divergences from the rule of equality could hardly be serious. Still less could they be made acceptable to the rank and file. There is no way of measuring how far differences in capacity for pleasure are real, how far fanciful. Virtually, distribution on the basis of need would mean that all should share alike.

This is perhaps the highest ideal; it conforms to the highest pitch of altruism. It has usually been accepted in the communistic societies which have been under strong religious influence. It is more or less consciously the ideal of those who find "socialism" in the teachings of Christ. But it is not proposed, at least not overtly, by most socialists. Many persons think that leveling is an essential part of socialism. Great mitigation of existing inequalities does seem to be universally demanded by socialists; and a lurking predilection for complete equality is found in the usual propaganda. Nevertheless almost all socialists have in mind, even though vaguely, some differentiation in the individual incomes.

The second principle, of sacrifice, means that men should be paid in proportion to the irksomeness of their labor. If all labor were equally severe and equally distasteful, this would mean that men should be paid in proportion to the time (hours and days) of their labor; for, by and large, a day's labor or an hour's labor means as much to one man as to another. The principle of sacrifice as measured by labor-time underlies the notion of an intrinsic or necessary value in commodities, resulting from the incorporation of labor in them. Marx had a doctrine of this sort. Value was said to be so much embodied

labor, a kind of labor-jelly; value being regarded not as a mere matter-of-fact phenomenon in exchange, but as a something inherent in economic goods. Quantity of labor — such quantity as is ordinarily and reasonably necessary — settles this inherent value. The doctrine really has in mind the principle that goods *ought* to be exchanged in proportion to the labor needed for producing them; and this, again, means that all labor *ought* to be remunerated on the same basis; hence that differences in duration and disagreeableness of labor should alone be the occasion for differences in its remuneration. In such a mechanism of exchange as was referred to in the preceding section (the use of labor tickets), goods would be valued according to the quantity of "socially-necessary" labor involved in their production, and sold on that basis.

In a scheme for an ideal society, which was much discussed some years ago,[1] it was proposed that all laborers should be paid at the same rate, but that the hours of work in different occupations should be adjusted in such way as to made sacrifice or irksomeness the same for all. Let the pleasant sorts of labor have long hours, — those of superintendence and government, for example, since "bossing" seems always to be agreeable. Let the dirty and heavy labor, such as mining and ditch digging, have short hours. Readjust the hours if it should appear from the deficiency or excess of applications for the several employments, that this handicapping by the length of working time was not accurate. The proposal is no more to be taken as an essential part of socialism than any other detail in the sketches of utopia. But it brings out clearly the principle of equality of sacrifice: not pay at the same rate for all, but pay at such rates as to bring the same sacrifice for all.

Equality of sacrifice rests on an ideal of liberty. Sacrifice, hardship, irksomeness, are subjective feelings. They can be measured only by giving men choice of what they shall do, and judging of their feelings according to that choice. Tacitly the assumption is that equality exists in the capacities of men,

[1] Bellamy's *Looking Backward* (1888).

and that all can turn at will to the several sorts of labor; or, at least, enough persons can turn freely to make it perfectly feasible to get a full quota for each sort. If we assume that all men have the same inborn abilities, and that there are no obstacles to free choice of occupation from custom, expense of preparation, or social environment, precisely this kind of adjustment of wages would ensue in an individualistic society. The only differences would be those that served to offset the varying disagreeableness of different sorts of labor.[1]

Very dissimilar is the third principle, that of remuneration according to efficiency. This says that each man shall be rewarded in accord with his contribution to the social income. The able, strong, and alert shall get more, the dull and weak less. The outcome would be in many cases quite the opposite of that from the principle of needs, under which the strong are likely to get less, the weak to get more.

Remuneration according to efficiency seems to most persons just. We think it right that he whose work accomplishes more shall get more pay, that an efficient man shall be paid at a higher rate than an inefficient one. The principle assumes, too, — though this assumption often is not consciously made by those who reason on it, — that efficacy is not the same for all, some having greater capacity than others. Remuneration according to sacrifice tacitly assumes perfect liberty of choice; remuneration according to efficiency tacitly assumes that not all men can do all things, and that not all are equally sedulous.

The ready acceptance of efficiency as a just basis of reward is the result of its being the basis on which reward is now in fact adjusted. In the main, men are paid for labor in existing society according to what they contribute to society; or, to be accurate, according to the marginal contribution of their sort of labor. On this matter, as on others, most persons accept as just that to which they are habituated. The real ground on which remuneration according to efficiency is to be justified is the utilitarian one. It spurs every man to contribute

[1] Compare what is said of differences of wages, above, Book IV, Chapter 47.

his utmost. The argument for it is the argument from the bribe. On the most altruistic ethical standard, there is no reason why the strong man should get more than the weak; nay, rather, there is ground for his sharing freely with the weak. The reason why he should get more is simply that, unless he is so rewarded, he is not likely to exert his strength. In the end, — this is the essence of the argument, — all men are better off when each is induced to contribute his utmost. If, indeed, all men are born with equal gifts and have equal opportunities, the final result will be the same as under the second principle, — all will be paid in proportion to sacrifice. Every one will be spurred to turn his labor to the occupations which are highly rewarded; in these numbers will increase, and reward then will diminish; ultimately, only those differences will remain which correspond to differences in irksomeness. But if there are inborn differences in capacity, some men will always get more than others, even though opportunities be the same for all. The resulting inequalities must be accepted as necessary in order to induce every man to exercise his own faculties, and to exert himself in acquiring by training and assiduity those faculties which bring about high efficiency and high reward.

Not many advocates of socialism have expressed themselves clearly on this fundamental question: what is the just or ideal apportionment of reward for labor. Often they think loosely and fail to discriminate among the possibilities. The trend among them, on the whole, is toward the second principle, — that of remuneration according to sacrifice. Strong as is the underlying protest against inequality, few would accept squarely and without qualification the first principle, — that of equality. Few, again, would be willing to accept all the consequences of the third principle. Often they ignore inborn differences, believing in the perfectibility of men; and in any case the great differences which flow from reward according to efficiency would not be in accord with their general striving for equality. Though only half conscious of doing so, the socialists are apt to propose or imply some sort of compromise: some inequality,

but not very much; some adjustment to efficiency, but not so much as to lead to marked inequality. Of the difficulties and problems which must emerge, more will be said in the next chapter.

§ 4. Before further consideration of the meaning and possibilities of socialism, it may be pointed out wherein socialism differs from public ownership, and from the humanitarian legislation which is often described as "socialistic."

Public ownership does not mean socialism as to distribution, that is, as to the thing essential. The state, in owning and operating railways, proceeds in much the same way as a private company does. It pays high salaries to the managers at the head less salaries to subordinate officials, ordinary wages to mechanics and unskilled laborers, — throughout on a scale like that prevailing in the world outside. No doubt, there is a tendency to mitigate existing inequalities. The higher officials often get less than persons of the same capacity would get in private employment; though this, again, has not infrequently the result that the officials are not in fact, as they are supposed to be and ought to be, of the same capacity as those in private employ. In democratic countries the mechanics and unskilled laborers are often paid more than they would be paid by private employers. But these are no more than differences in degree, and rest on no clearly conceived principle. In the main, the existing differences of wages are accepted in public business management.

Again, public ownership does not do away with the leisure class. When the state turns to railway ownership and operation, it buys out the private owners, who thereafter simply receive their income from other investments. Such purchase often results simply in an exchange of public securities for corporate securities. The same consequence ensues when the state sets out to own great works from the beginning (as the Australian colonies did in building their railways). It then borrows the funds, and pays interest to the creditors. The leisure class still gets its income.

No doubt it is true that public ownership means an endeavor to mitigate inequalities in distribution. Monopoly returns are to be done away with, or (what comes to the same thing) are to be appropriated by the community. But this is by no means inconsistent with the conduct of the great mass of industrial operations by private hands, with all the resulting phenomena of private property, — inequalities in earnings, savings and accumulation, investment, a leisure class, a stratified society. There is a vast difference between the mitigation of present inequalities and the complete removal of the causes which lead to the inequality characteristic of the existing régime.

Similarly, the whole series of social reforms, from the regulation of the large-scale industries to factory legislation and old-age pensions, has a limited range. It looks also to the mitigation of inequalities and of the results of inequalities. All these measures serve to determine the plane on which competition shall proceed, but do not put an end to competitive bargaining or competitive returns. Factory legislation, for example, workmen's insurance, even minimum wages, fix the limits within which the bargains shall be adjusted, but they do not attempt to settle the bargainings. The case would be different if the state were to go to the point of actually fixing wages, say by a method of compulsory arbitration. This, as has been said already, involves a principle more far-reaching than the other forms of labor legislation; since, carried to its logical conclusion, it calls on the state, by fixing wages once for all, to settle not only wages, but the other elements of distribution as well.[1]

It may be said, of course, that all these things — public ownership, regulation of industry, labor legislation — rest on the same principles and ideals as socialism, that they look in the same direction, and that they will lead ultimately to a socialistic state. They do rest on the same or similar impulses, — a wider altruism, a growing impatience with great inequalities. So far they look in the same direction. But their ulti-

[1] See above, Book VI, Chapter 57, § 6.

mate outcome is by no means necessarily the same. That outcome may be a purified and better society, still organized on a basis of property and of free bargaining. Oddly enough, the advocates of socialism and its extreme opponents unite in a vague and all-embracing conception of the movement, the former by calling every step for social reform "socialistic," and the latter by stigmatizing with the same name every measure to which they object. Little is gained by such discussion toward understanding the problems really involved in the scheme of a radical reorganization of society.

§ 5 Some current objections to socialism are easily met.

It is said that the scheme is too huge, the difficulty of organization insuperable, the actual operation sure to break down because of the extent and complexity of the industrial problems. But the large-scale enterprises of modern times go far to dispose of the objection. The possibilities of organization have been proved to be immense. When we see how railways and industrial enterprises are successfully conducted on a vast scale under unified management, we cannot say that the mere difficulties of management and operation would be insuperable under socialism. In fact, many of the problems of production, exchange, transportation, would be simplified. Fluctuations and uncertainties would largely disappear. Only the inevitable irregularities of the seasons would have to be reckoned with. Overproduction of any one commodity could be easily set right, by simply waiting until the existing supply was disposed of. There could be no ruinous underbidding by frantic competitors, each rushing to market in the fear that the other would undersell. It is true that the system, order, regularity, which the socialists may fairly claim as belonging to their society, may mean also stagnation, — the cessation not only of change, but of progress. But this amounts to saying not that administration and management are impracticable, but that they would not be as progressive as they should be.

Again, there would seem to be no insuperable difficulties in the way of valuing commodities in the socialist state. The

pricing of the goods on sale would involve, to be sure, not only accurate bookkeeping (of the cost-account sort), but the determination of the wages of the laborers engaged in the several branches of production. In other words, it would presuppose a scheme of distribution among the laborers. This, as already intimated, and as will presently be further shown, is a crucial matter. But supposing the principle or standard to be settled, the next step, that of fixing a price for the goods produced by different kinds of labor or different combinations of labor, is not more troublesome than it is now for a great manufacturing establishment. Often enough, in existing industrial organization, figures of cost and price can be reached only with approximation to accuracy; but a reasonable approximation suffices.

Nor would "the accumulation of capital" be a matter of serious difficulty. It would simply proceed by a different process from that of present society; not by savings and investments of individuals, but by the deliberate setting aside of part of the community's resources for new construction. As at present, it would depend on the existence of a surplus, an excess over what may be used for satisfying current wants. In this sense, there would be "abstinence" and saving in the socialistic state. But it would be "abstinence" not by a comparatively few, but by all. Each and every individual would have his present income curtailed somewhat, in order that provision might be made for adding to the outfit of the community. Success in making such a provision would depend of course, on the possession of a fairly high level of income; that is, on an existing high productivity of labor. Given a sufficient present income, there would be no difficulty in setting aside something for addition to the community's capital. The serious problem would be whether there would be continued progress and invention, not whether there would be the means for carrying out inventors' projects.

It is often said that socialism would be destructive of liberty. But for the great majority of mankind, freedom might be no

less than it now is. Most men now find the nature of their occupations fixed for them. Their daily round is settled virtually without choice of their own. Change from one occupation to another of a similar grade would seem to be no more difficult of arrangement in the socialist state than in our own. If the dreams of the socialists come true, there would be shorter hours for all, and more leisure. But greater freedom in this sense is not unattainable in existing society. If the dreams of the non-socialists come true, toil will be less all-absorbing, free time more plentiful. For the mass of men, it is not clear that on the score of liberty there is a preponderance of gain under either system.

Whether persons of unusual gifts would have greater freedom, is again not easy to say. Unless real freedom could be secured for them, real opportunity for development, no dreams of the socialists could come true. A stiff and bureaucratic socialism — and danger there is of crass bureaucracy — would stifle individuality. This is a matter of the kindling of ambition and emulation, the selection of leaders, the maintenance of progress,—difficulties which, as will presently appear, are the crucial ones.

Obviously, there would be loss of freedom for many who now are privileged. The commonplace persons of the well-to-do class, with an "independence" of their own to fall back on, would have less choice of occupation, less chance for experiment, less freedom as to their mode of life. The abolition of the régime of privilege would necessarily destroy some advantages of the privileged. That elegant freedom now enjoyed by the possessors of large funded incomes would disappear completely.

We are so habituated to the ways and traditions of present society that we cannot easily imagine what would be those of a society essentially different. There is no such thing as unrestrained freedom. Men live now within limits set not only by the need of earning their living, but by law, by custom, by the environment. In the socialist state there would be neces-

sarily restrictions also, in some respects similar, in some respects different. A bureaucratic and semi-military socialism is conceivable which would crush individuality. A regulated and refined system of private property is conceivable, with unfettered freedom of opportunity, in which there would be a completeness of liberty hardly to be attained in any socialist state. If we conceive the *summum bonum* to be the full development of personality, we must hesitate before saying which sort of social organization gives the promise of the best happiness.

CHAPTER 65

SOCIALISM, *continued*

§ 1. Let us now consider some difficulties in the way of socialistic organization which are more serious.

Though socialism would not destroy the home or the family, it would bring domestic relations very different from those with which we are familiar. The socialists are justified in scoffing at the bugbear of phalansteries and barracks, with supposed gigantic nurseries, — quasi incubators, in which children would be reared without parental love or guidance. Yet inevitably the family would be in an environment very different from that of the present, its influence much diminished, the relations of parents to children greatly modified, the problem of population more ominous.

Education and training, it would seem, must be completely under state control. The training of the young and their preparation for a career in life could not be left to the discretion of parents. At the least, it would be subject to minute public control. And, on the other hand, the responsibility of parents for the future of their children would virtually cease. Every child would not only be taught the fundamental things, but properly fed and cared for. Its education would be pushed as far as the constituted authorities might deem worth while. And a necessary corollary would seem to be that every child should be assured employment, and as good an opportunity for earning an income as any other child of like promise.

Malthusianism was held up by the economists of a generation ago as an insuperable obstacle to any collectivist scheme. The socialists have commonly pooh-poohed it. But it is none the less serious. The decline in the birth rate and the lessening pressure of population, which appear in the highly civilized

countries, are the consequences of individualism and the régime of property.[1] These tendencies, salutary on the whole, rest on stirred social ambition more than on any other force. They are due to the present position of the family, to hope for the future of one's children, to the desire to rise in the social scale. It has been shrewdly said[2] that the natural man has only two primal passions — to get and to beget. The desire to beget is now held in check by the desire to get. That removed, what would check multiplication?

This is a thorny subject, not often entered on coolly and openly either by socialists or their opponents. Man the animal tends to multiply like other animals, and when he does so encounters essentially the same obstacles as other animals. Regulation and relaxation of the tendency to increase are imperative, yet are fraught with dangers, — physiological and moral as well as social. These dangers and evils are ominous in existing society. So fundamentally different would be a collectivist organization that it would be rash to predict just what dangers could be avoided in it, just what would be inevitable. Yet I cannot but believe that some coarse and mechanical regulation of the sexual relations would have to be resorted to; a formal retention, no doubt, of monogamy and of family obligations, yet without those concomitants which now make the family a safeguard for public and private well-being. The sexual relations are made pure and sweet, and safe for society, not only by the marriage tie and the lawfulness of monogamy, but by care and responsibility for the offspring. Without that responsibility and all the ambition and affection that go with it, the animal instinct bodes vast dangers. The domestic relations which now enshrine it are highly unselfish within the narrow range of the family, but highly selfish as regards the rest of the world. In their essence, they are individualistic; and it is their very individualism and selfishness which cause them to work to social advantage. It

[1] See Book V, Chapter 53.

[2] By Dr. Osler, *Science and Immortality*, p. 10.

is hardly conceivable that any new development of public opinion, any new regulation by public authority, any decreeing of childless monogamic unions, should replace the restraints, the sanctions, the motives for both industry and economy, which the individualistic family gathers about it under conditions of free opportunity and of hope for the future.

§ 2. The maintenance of vigor, efficiency, and progress presents problems no less troublesome, both as to the rank and file, and as to the leaders.

For the rank and file, some among the difficulties in the existing order of things would indeed disappear. There would be no inducement to "make work" or oppose improvements. The fear of unemployment, which is the main cause of the disposition to adopt such policies of restriction,[1] could not have influence in the socialist state. The laborers who were no longer needed in one occupation or in one locality would be transferred elsewhere; if immediate utilization proved not feasible, with no loss or suffering during the transition. There would be no inducement for making any job last.

But there would also be no right of discharge; none, certainly, that could be exercised with effect, least of all in a democratic community. Criminals, tramps, ne'er-do-wells, would indeed be comparatively easy to deal with. They could be immured, kept from breeding, and, if beyond redemption, got out of the way painlessly. The serious problems would be presented by the rank and file of men, not hopelessly bad, not spontaneously good. How deal with mere slackness, indifference, the lazy stroke? No threat of discharge could avail; for non-employment and work-seeking are quite to be done away with. The community must deal with the men once for all either as workers or as delinquents.

If, indeed, labor were not ordinarily irksome, and if work were always done cheerfully and spontaneously, no difficulties would arise. We return here to some of the very problems with which we began.[2] It may be true that a life without labor is

[1] See above, Book V, Chapter 51, § 3. [2] See Book I, Chapter 1, § 4-6.

demoralizing and unhappy; and it is certainly true that a life of inactivity is miserable. But steady labor at monotonous tasks, such as is essential for the productiveness of industry, is evaded by almost all men. In an ideal state, we should wish to have good work, good pay, good leisure; but will men do good work if assured in any case of good pay and good leisure? Spontaneity in labor seems inconsistent with large-scale operations. It is found only when men work for themselves, or in groups where each works for all under the eyes of all. The larger the group, and the more remote the connection between each individual's labor and the final output, the less likely is it that men will work faithfully without some machinery of enforcement and penalty. The problem is similar to that universally encountered when taxation is resorted to for defraying public expenses.[1] The services being freely supplied to all through taxation, — there being no precise *quid pro quo,* — all grudge the taxes that must be paid in order that government shall be able to supply the services. Hence the mien of the taxgatherer is inevitably harsh. In a socialist state all ostensible workers would be assured once for all of getting their share — on whatever principle adjusted — of the results of collective activity; and hence some sort of pressure would have to be exercised in order to induce vigorous and effective work. Must not the socialist taskmaster be harsh, like our present taxgatherer? And what penalties shall he apply?

We may conceive, indeed, that a socialist state shall undertake to adjust distribution on a basis of efficiency, and thus shall attempt to apply a spur to vigor by differences in pay proportioned to zeal as well as to capacity; frankly accepting the wide range of differences which must result from that principle. The greatest variations from the average or ordinary rate would then appear, of course, for the case of the comparatively few having great gifts, for the great leaders and administrators, the men of science and the inventors, — and

[1] Compare Book VIII, Chapter 66, § 1.

surely, the poets and artists also. But differences of the same sort, though less in degree, would appear in the rank and file also. The interest of every private employer now leads him to make distinctions on this basis. He selects for well-paid positions the steady, zealous, and intelligent, and relegates the dull and indifferent to tasks that can be mechanically measured, — or he discharges them once for all. Is it to be supposed that public officials, having no stimulus from any interest of their own, will discriminate in such way as to stir zeal and intelligence, penalize laziness and incompetency? Above all, will the public officials of a democratic community do so?

Whether a man shall contribute more or less to the general output of the community depends in most cases on his own spirit, — on his choice and will. Conspicuous ability and the temperament that leads to its exercise present a special problem: how to discover the ability, how to stimulate it. For the vast majority of men, efficiency in work depends on striving, on self-imposed habits. People do not know how much they can do until they are compelled to try. The virtue of the system of competition, of private interest, of self-dependence, is that it leads men to try hard. No doubt, it often fails. Among the very poor, it stunts endeavor; and there is lack of opportunity for developing latent faculties. At the opposite extreme, many of those born to riches waste valuable powers. But most men, being dependent on themselves and prosperous in proportion as they exert themselves productively, are led automatically to do their best. This great and seemingly indispensable motive force, no socialistic scheme can bring to bear with effect.

§ 3. Similar questions arise as to leadership. All progress, material as well as spiritual, depends on the selection of the right leaders and on spurring them to the best exercise of their faculties. What is the outlook for effective leadership under socialism?

The possibilities seem to me greater than some critics admit. The essential thing, say the socialists, is to find new and better

ways of inciting emulation and satisfying the love of distinction. What men chiefly strive for, and above all what men of leadership strive for, is fame, place, and power. In some degree, too, they are prompted by the mere instinct for the exercise of their gifts. Not the poet and painter and musician only, but the man of science and the administrator also are impelled by an instinct for achievement. Add to this the stimulus of emulation, of widespread appreciation, of conspicuous distinction, and the sordid rewards of present society can be dispensed with. Give free play for the exercise of genius and power, — then the ribbon and the laurel wreath will suffice as rewards.

The psychology which underlies this train of argument is surely better than that older one which supposed that all men have a simple desire for wealth *per se*. Other things than riches and worldly success appeal to the artist and the man of science. The leader in business also is open to other and higher ideals. Government posts even now have an attraction which goes far to outweigh the higher pecuniary rewards of private business. The captains of industry and fortune builders are actuated by very mixed motives. They follow the traditional paths of emulation, themselves but dimly conscious that the wealth they pursue is, after all, but a symbol of achievement and success. What stirs them more than anything else is social ambition. Therefore, say the socialists, the essential thing is some symbol of eminence that shall put the possessor above the common herd as conspicuously as riches now do.

It must be admitted that emulation and imitation underlie the doings of industrial leaders, as of others; but it does not follow that the particular kinds of appreciation and recognition familiar in our system of property and inequality can be dispensed with. Coarse men need coarse stimuli. It must be doubtful how far the typical person of business ability will respond to more delicate stimuli. Even among persons of intellectual and spiritual bent, there is a mixture of motives. Creature comforts, pride of place and power, command of the

services of others, are not entirely despised even by poets and philosophers. As few men are wholly selfish and few wholly altruistic, so few are wholly moved by the higher or by the lower forms of the love of distinction. It is not often that the laurel wreath alone suffices to satisfy ambition.

Much depends on the growth of altruism; and this again depends on the spirit that pervades the community. The nobler and wider feelings may be fostered or smothered in the individual by the atmosphere which surrounds him. We may expect, with the better development of democracy, with the spread of education, the elevation of character, the clearer understanding of social and economic problems, that the environment will become more favorable to emulation in service. A simpler way of giving rewards and distinctions will prove effective in proportion as the sense of common interest is stronger in its hold on all. But this is a matter of slow evolution. It is not to be supposed that a mere change in institutions will at once overturn the deep-rooted self-regarding impulses or modify their paths of action.

§ 4. Another problem is that of selection. Granted that ways can be found in the socialist state to stimulate and reward the persons fit for leadership, how pick them out?

The gradations of ability, talent, and genius are not recognized early or measured with ease. Those who show promise must go through a stage of trial. High intellectual capacity, unlike bodily dexterity, does not appear at its full until long after adolescence. Poets, musicians, painters, scholars, look back with mingled curiosity and amusement on the work of their early years. Often those whose achievements in later life prove greatest could not be singled out in youth from their competitors. Men of affairs, especially, are bred in the hard school of experience. The more promising are indeed readily picked out from the rank and file. But in what degree they are promising, and how far they will ultimately advance, is not evident in the early stages.

No community has produced great poets, sculptors, musi-

cians, except by the emulation and competition of a large body of aspirants. Many try, few succeed. So it is as to men of science, inventors, business leaders. Often it is the most brilliant of all, in every field of achievement, who find it hardest to make their way; because they are ahead of their time. Those most readily gain place and appreciation who have high ability, but not the originality of genius, — the poets and painters who do that to which the general taste has already been educated, the leaders in science and industry who apply principles already established. On the other hand, there are always hosts of men who undertake to break new paths, but prove not to have it in them. The world is full of would-be geniuses and crack-brained schemers. Persons who are now called on to take the initiative in the processes of investment, such as bankers, hardly pass a day without having new projects urged on them, — some obviously absurd, some doubtful, a few promising. An exercise of good judgment is necessary before novel enterprises can be launched with promise of success; and then must follow a period of experiment to test the outcome. The same holds good as regards the selection of administrative officers, managers, heads of large enterprises. It does not appear in advance who has the particular qualities that make an effective leader; least of all, who has those that make a great path-breaking leader.

By whom is the process of selection to be carried on when there is nothing analogous to the "natural" selection of present society? The discouraged and rejected will then be no longer free to seek some one else to back their projects. They must accept once for all the decision of the officials in charge. Governments now find it hard enough to do things in the ways already approved by experience, and to select for their work men whose qualities for leadership have already been tested in private industry. How would it be if the responsibility for selection and promotion were entirely in the hands of officials? Even those public business enterprises in which management is now most efficient, are apt to be a refuge for mediocrity, or,

at best, for safe clinging to established methods. Men of new ideas and far-reaching projects find no hearing. The same reasons which lead to the conclusion that in existing society government can advantageously take charge only of industries that have reached the stage of maturity,[1] tell even more strongly against the control by government of all industry. It is conceivable that democracy will choose honest and efficient leaders; even this awaits the proof of experience. It is well-nigh impossible to conceive that any governmental organization, democratic or autocratic, will be able to pick out the men of originating ability. A vast collectivist organization would hardly fail to be deadening to genius of all kinds. Would not its selection of leaders be at best a recognition of ability to do well what is already well done?

§ 5. Considerations of a similar sort apply to the development of capital. The mere accumulation of capital in a socialist state is perfectly feasible, as was noted in the last chapter; that is, the setting aside and "saving" of a surplus. But this is only the first step in the process by which real capital is added to. Tools, implements. "capital goods," are not saved; they are made. More of them can be made to advantage only if there is progress in the arts. The effective increase in the community's capital can take place only by improvement and invention.

In the sketches of utopias, there is commonly reference to the great mechanical improvements which will be seen in the ideal society, — vast systematic plant, automatic devices, supersession of dull manual labor by ingenious machines. The schemers speak as if these things came of themselves. In fact the great mechanical advances have come in the past by slow steps, with experiments and failures; dependent on the accumulation of surplus means, but not caused by it. Though the future is likely to see tools perfected far beyond what we now possess, all such devices will come, as they have come in the past, by trial, by selection, by evolution. There must be not

[1] See Chapter 62, § 2.

only the means for getting new capital made, but organizers and inventors. The process of merely adding to the number of existing tools and machines is easy. When once the turbine engine and the automatic power loom have been perfected, almost any one can make more of the same kind. But to improve the loom or the turbine still further calls for a very different procedure and a very different kind of man.

The increase of effective capital is thus closely interwoven with the selection of capable leaders. Both are essential for continued progress. For both, existing society offers the bait of riches. With an ideally-perfected community and with ideal leaders spontaneously chosen, all things are indeed possible. But under a non-competitive organization, even in a community far advanced in intelligence and character, there would seem to be but slender prospect for sustained material advance.

It may be said, of course, that advance in production is no longer a matter of the first consequence. Better distribution may be thought the prime requisite. If the whole income in civilized communities were equally divided now, would not all have enough? Possibly; the question is simply how much suffices. It would probably be a liberal estimate of the average income of a family in the United States, the most prosperous country on the globe, if it were stated at one thousand dollars a year. When we consider what this means, in food, shelter, clothing, education, recreation, we can hardly be content to let it stand as the last stage in material progress. Surely it is but the beginning of what we may hope to see in the centuries to come. Those who dream of the great perfections to be seen in the socialist state, of the perfected automatic machines and the superabundant products, *ipso facto* confess that much beyond the present stage of productiveness is desirable. And the more "scientific" socialists, also, when they speak of the inevitable victory of large-scale production, of the disappearance of the small producer and the middle class, imply that there is still occasion for those advances in the arts on which

the spread of large-scale production depends. Such advances, to repeat, do not come by any automatic process; nor is it probable they will be achieved in the future in any other ways or under any different motive forces than those which have acted in the past.

§ 6. The questions between private property and socialism are thus at bottom questions as to men's character, motives, ideals. They are questions, in so far, of psychology; in more familiar language, of human nature. They are not simple, but highly complex; because human nature is highly complex.

What is sometimes called "strictly economic" reasoning rests on the assumption of deliberate intelligent choice of the procedure that brings the most gain to the individual. It assumes hedonism in its simplest form. Motives other than the self-regarding ones are supposed to show themselves only in matters that belong outside the "economic" sphere, — in the family relations, in religion, in charity, perhaps in political action. But human nature is not so simple as this, nor so neatly divided into disparate parts. Men are not wholly selfish or wholly unselfish. True, in most of their dealings with strangers to the blood, they pursue their own advantage; and it is this fact which gives validity to "strictly economic" doctrines. But they do not follow their advantage ruthlessly. In the future they may follow it even less ruthlessly than they do now. They may be restrained not only by the law, but by a higher moral sense. Human nature varies in this regard from age to age, and often varies for the same individual with his own changing years. It may improve so much in the future as to make feasible plans of social reorganization which now seem quite utopian.

So it is with the impulses of emulation and distinction. In the past they have turned usually to some form of domination, in accord with that instinct of struggle and conquest which we have inherited from savage ancestors. Power over others has been the keynote of political and economic history. It was at

the base of the feudal system. It affects enormously, though half unconsciously, the struggle for wealth in modern society, whose ways of emulation are still much under the influence of the feudal traditions. The love of distinction is so universal and so rooted that it cannot be eradicated. But it can conceivably be turned into directions which, while still satisfying the ineradicable impulse, will lead to a wider spread of the elements of happiness. A spirit of service may replace the spirit of domination, and emulation may be for the greatest promotion, not of the individual interest, but the common good.

We are much better men than our savage ancestors; more altruistic, on the whole, as well as more intelligent. Of this general betterment the last hundred years have supplied many illustrations. Suffering will not be endured as it was in former times; the mere description and exposure of it means that something will be done to stop it. The abolition of cruel punishments is a phenomenon of large significance. The steady development of social legislation, and the increase of charitable and educational endowments, are other results of the sense of common interest, of the growing altruistic impulse.

From this point of view, it may be said that all the great social movements of modern times rest on the same basis, and that all tend away from individualism and in the direction of socialism. Though important distinctions exist, as has just been noted,[1] between full-fledged socialism and public management of selected industries, it may none the less be maintained that the movement for public management and control rests on the spread of a more altruistic spirit. And the substitution of public for private management is not only impelled by this higher social spirit, but depends for its eventual success on a high level of character and intelligence. Of labor legislation, also, it is to be said that it is both impelled by the spread of better ideals in the community at large, and dependent for its ultimate good results on betterment of character among the laborers themselves. Thus the differences in spirit, in method,

[1] See Chapter 64, § 4.

in limiting conditions, between socialism and other movements for reform, may be said to be only differences in degree.

But the differences in degree remain vast; and such radical transformations in human nature and in human institutions as the socialists expect are not to be looked for within any stretch of time of concern to present generations. How far changes in men's motives and ideals, and so in their public and private relations, will ultimately go, it would be rash to predict. But it is certain that they will proceed very slowly. For long ages men will remain very much as they now are, responsive in some degree to the higher and larger impulses, yet in most of their dealings with each other acting mainly under the sway of those lower and narrower. They will need to be spurred to vigor, to the full exercise of their powers, to self-restraint, by their own needs and interests and by the selfish altruism of the family affections. So long the system of dependence on one's own exertions, of bargaining between individuals, of private accumulation and private ownership, will persist.

It may be suspected that the divergence of opinion on the possibilities and ideals of socialism often hinges on differences between the disputants in character and temperament. Persons of highly altruistic character easily believe that others will respond to the motives that actuate themselves. Those, again, who are most happy when engaged in useful labor, even though it be sustained and monotonous, believe that others will cheerfully work, as they do, with little regard to the rate of remuneration. So it is with the ideals of life and the ultimate sources of happiness. To some opponents of socialism, its program is unattractive because it offers a world without strife, — as tame as a sport without danger. To them, peaceful emulation and competition only to serve the common good are things flat and stale. They see no zest in life without the prospect of victory, and therefore the possibility of defeat. And so it is as to a stereotyping of life which would seem to be, in some degree at least, inevitable in a socialist state. The advocates of individualism

say, let men ruin themselves, if they will, and bring ruin on those nearest and dearest to them; can they rise to heights of happiness and perfection, of full development of personality, unless they have a choice in shaping their careers to the sweet or bitter end? Persons of a placid temperament, on the other hand, are attracted by peace, security, mutual help, assured comfort; a world with no glittering prizes, but no abject failures. Freedom means different things to different people. To some, it promises nothing unless it be the choice to compete and to win and to reap the fruits of winning. To others it means escape from pain, from the need of holding one's own against superior competitors, from the subjection of defeat. Such differences in temperament can be brought into accord by no reasoning. Hence the debate on the merits and attractions of private property and socialism may be expected to go on indefinitely.

§ 7. In the preceding pages, no far look into the future has been essayed. Only for the next few generations can we venture on some predictions. Public ownership will spread, though how far we cannot be sure. The plane of competition will be raised; the institutions of property and inheritance will be narrowed in scope. For the immediate future we see some reforms clearly called for, others awaiting inquiry and trial. But what of the final outcome? Will the evolution of society eventually proceed to the socialist state?

The so-called materialistic interpretation of history, as worked out by Marx and adopted by others of more or less socialist drift, tries to give an explicit answer. The future will inevitably bring the disappearance of private ownership in instruments of production and the elimination of the property-owning and income-receiving class. Stripped of its inessentials, the prediction is simple enough. Large-scale production will spread further and further; the small producer and the middle-sized will disappear; there will remain only a few great capitalists and a propertyless proletariat; the masses will become more intelligent and conscious of their power; the capitalists will then be dispossessed (possibly but not neces-

sarily by bloody revolution), and the fully organized socialist state will emerge.

One thing is certain: the overturn is not imminent. At the time of the revolution of 1848, Marx thought that the final stage in this industrial evolution was setting in. The first stage, long extended, had been that of the direct exploitation of the laborer through slavery and serfdom. During the second stage, lasting from the time of the industrial revolution in the eighteenth century to the middle of the nineteenth century, the property-owning class had exploited the free laborer. The third and last stage, that of the emancipation of the laborer through dispossession of the capitalist, was supposed to be ushered in by the revolution of 1848. But of this prediction as little has been fulfilled as of the confident expectation then cherished by others that an era of universal democratic government was setting in. The uprising of 1848 subsided, with few immediate changes in political or social structure. Its lasting effects, fused with those of other movements, came about by slow and gradual changes. The face of society has been much altered in the last fifty years, but it has not been revolutionized.

The socialists themselves are coming to recognize the inevitableness of gradual change. A curious controversy is going on in Germany within the socialist ranks, between those who hold to the strict Marxian doctrine of impending revolution and early dispossession, and those who, maintaining that changes will be slow, advocate a policy of opportunism. Marx's *Capital* has been a sort of bible in the German socialist camp. Though the book contains, with evidence of extraordinary intellectual ability, much obviously untenable matter, the loyal socialists are unwilling to give up any of its teachings. Yet the proof is brought, by socialists no less convinced than was the leader, that his predictions as to economic evolution are wrong. The middle class is not disappearing. The number of the rich grows, but the number of the moderately well-to-do grows also. Great establishments increase, but vast-scale production does not cover the whole industrial field, and there is as yet no indi-

cation that it will.[1] Democracy extends, and the trade-union movement grows. But there is little sign of an impending class war, or of a resolute and conscious adoption of the socialist principles by organized workingmen.

It is true that changes are likely to proceed more quickly in the future than they have done in the past. The spread of education, the ease of communication, the enormous facilities for propaganda through cheap printing, make public opinion more mobile. The inertia of settled habits is less. Moreover, the last fifty years have seen wonderful changes in industrial organization as well as in the mechanic arts; the next fifty years may see changes as great. The consolidation of industry will probably become accentuated, and public ownership will almost surely spread. The twentieth century before its close is likely to see developments that would seem unthinkable to the staid American business man of our own time.

But the fundamental social institutions will not be quickly revolutionized. As compared with such an overturn as the uncompromising socialist would bring about, the most radical changes now in prospect will leave the face of society very much the same. The Australian colonies now have public ownership of railways and other great enterprises; they have compulsory arbitration and minimum wages; they have progressive taxation and the like. But they have competition and money-making, social classes and pecuniary ambition, marked inequalities in property and income, idle rich and overworked poor. The traveler who journeys there finds a state of things not essentially different from that in the United States, where the individualistic traditions retain their hold so much more tenaciously. Society can go a long way in overhauling present institutions without approaching the socialist goal.

The reason why the process of social evolution is slow is that men themselves change slowly. Not only human nature and

[1] Compare the figures already given in Book V, Chapter 54, §§ 1-3, and in Book I, Chapter 4, § 1. See also Bernstein's *Evolutionary Socialism*, English translation, p. 57. Bernstein is one of the best-known among the non-orthodox German socialists, an able and high-minded writer.

human motives, but the current standards of right and wrong, the beliefs as to what constitutes right government, right ownership of goods, right relations between men and between men and women,—these foundations of society are extraordinarily stable. Even when shaken by a great upheaval like the French Revolution, they prove in a short time to have been little disturbed. They are maintained from generation to generation by the unseen but pervasive influence of example and imitation. The slowness with which education works out results on any large scale illustrates the difficulty of changing habits of thought and conduct among masses of men. Better education is rightly deemed the greatest of social solvents; but it is hard to bring a real influence to bear on the millions who are to be affected. The educational leaders tell us that the things to be aimed at are clear thinking, accurate observation, training in the independent use of the faculties,—above all, conscience and character. Yet even the greatest educational advances go but a little way toward attaining these elusive ends. How slow is the improvement in methods of education, how much slower the influence on the character and the daily life of the individual!

The question, none the less, persists whether there is not a goal for the development of society. Though one may be convinced that the full-grown socialist state is not to come in any visible future, may it not come in the end? I cannot believe, for myself, that it is possible to foresee what the distant future will bring. Consider what was the state of civilized society some four hundred years ago, at the culmination of the Renaissance and the first stages of the Protestant Reformation: who could then imagine what development would take place in the coming centuries, what political, social, intellectual, industrial changes would occur? No less impossible is it for us to conceive what will be the changes in the centuries that lie before us. The system of private property, if it maintains itself, is indeed likely to be very different from what it is now; but whether it will remain unchanged in essentials, or will be gradually stripped of

many features now deemed essential, or transformed at last into something like the socialist state, — all this we cannot foretell.

The impossibility of seeing far into the future is admitted by the less fanatical among the socialists themselves. The abolition of great extremes in income, the guarantee of decent comfort to all, the disappearance of a leisure class, the assumption by the state of the overshadowing great-scale industries, the control of all natural resources, — these, indeed, seem to be essential points in this program. But just how far gradations of income may be allowed to remain, how far individual ownership of property may persist, what play may be allowed for some sorts of competitive industry, are matters on which their program is unsettled. Each is entitled to construct his own utopia. With this haziness as to the ultimate goal, many socialists accept a tentative and sometimes wavering procedure. The revolutionary wing is less dominant, opportunism more widely accepted. All sorts of changes in present society are welcomed, so long as their general drift is in accord with the collectivist ideal; such as workmen's insurance and labor legislation, state ownership and control even within a narrow range. Coöperation and trade-unions among workmen are no less welcome, even though the scope of these movements be strictly within the system of private property; since they are means of educating the members and training them in habits of common action.

It is fortunate that men of all shades of opinion can work together in the reforms that are called for in the visible future. The ultimate outcome may be allowed to take its own course. Little that we now do can have much effect in shaping it. The discussion of socialism is by no means barren. It centers attention on the fundamental problems of society, on the basis of existing institutions, on the sources from which coming growths must proceed. It points to a goal that has had charm for some of the noblest of men. It deserves the respect even of those to whom the goal is not attractive, or to whom it seems

quite unattainable. But it affects in no serious degree present endeavors and aspirations. As to these, there is a noteworthy accord of opinion. The course which society should take for the next generation or two is not obscure, and all men, socialists as well as social agnostics, can join in efforts to turn it to the direction admitted by almost all to be that of progress.

References on Book VII

W. Z. Ripley, *Railroads: Rates and Regulation* (1912) and *Railroads: Finance and Organization* (1915), give a wealth of information on American conditions. A. T. Hadley, *Railroad Transportation* (1885), though of older date, has not been completely superseded. W. M. Acworth, *The Elements of Railway Economics* (1905), and E. R. Johnson, *American Railway Transportation* (new ed., 1910); the latter written primarily as a textbook for American colleges. An able monograph is M. B. Hammond, *Railway Rate Theories of the Interstate Commerce Commission* (1911); compare J. M. Clark, *Standards of Reasonableness in Local Freight Discriminations* (1909). Among foreign books, C. Colson, *Transports et tarifs* (1908), technical and detailed, is of high value.

On combinations and trusts, R. Liefmann, *Kartelle und Trusts* (1909), gives an excellent compact account of the German situation; and H. W. Macrosty, *The Trust Movement in British Industry* (1907), a detailed survey of that in Great Britain. Books dealing especially with American conditions are R. T. Ely, *Monopolies and Trusts* (1900), J. W. Jenks, *The Trust Problem* (1900), E. S. Meade, *Trust Finance* (1903), L. H. Haney, *Business Organization and Combination* (1914); E. D. Durand, *The Trust Problem* (1915).

On public ownership, L. Darwin, *Municipal Trade* (1903), is an acute critical book, by an opponent; a briefer statement of the same reasoning is in this author's *Municipal Ownership* (1907). S. O. Dunn, *Government Ownership of Railways* (1913), gives effectively the arguments against. A convenient summary is in a series of papers, *The State in Relation to Railways*, published by the Royal Economic Society (1912). A mass of information and discussion on both sides is in the *Report on the Municipal and Private Operation of Public Utilities*, published by the National Civic Federation (3 vols., 1907). A detailed treatment of the relation of municipalities to "public utilities" is in D. F. Wilcox, *Municipal Franchises* (2 vols., 1910-1911).

The books on socialism deal largely with controversies which do not proceed to the heart of the matter. This seems to me to hold of K. Marx, *Das Kapital* (English translation, 1891), the most famous and influential of socialist books. Among the innumerable discussions and refutations of the Marxian doctrines may be mentioned E. Böhm-

Bawerk, *Marx and the Close of his System* (English translation, 1891), J E Le Rossignol, *Orthodox Socialism a Criticism* (1907). A concise and vigorous statement, based mainly on Marx, is in K Kautsky, *The Class Struggle* and *The Social Revolution* (English translations, 1910) J Spargo, *Socialism* (1906), is another popular statement of Marxian tenets and proposals

Among expository and critical books, A Schaeffle, *The Impossibility of Social Democracy*, and *The Quintessence of Socialism* (English translations, 1892 and 1902), are excellent, especially the last named Cp O D Skelton, *Socialism, a Critical Analysis* (1911) An admirable historical and critical sketch (on the wider relations of socialism, as indicated by the title) is W Sombart, *Sozialismus und Soziale Bewegung im 19 Jahrhundert* (Engl translation, 1909) A compact discussion of the literature on socialism through the nineteenth century, and of the social democratic party in Germany, is in H Herkner, *Die Arbeiterfrage* (5th ed 1908) Cp also R T Ely, *French and German Socialism* (1883) The most stimulating and discriminating advocacy and discussion of socialism is often by writers who do not pretend to be "scientific" Such are H G Wells, *A Modern Utopia* (1905), and *New Worlds for Old* (1908), and G Lowes Dickinson, *Justice and Liberty* (1908).

On this Book, as on Book VI, see the bibliographical memoranda in the *Guide to Reading and Social Ethics and Allied Subjects*, published by Harvard University (1910).

BOOK VIII

TAXATION

CHAPTER 66

Principles Underlying Taxation

§ 1. The essence of a tax, as distinguished from other charges by government, is the absence of a direct *quid pro quo* between the taxpayer and the public authority. It follows that a tax is necessarily a compulsory levy. The post office illustrates the payments which are different from taxes. A charge is made by it for each letter; no one is compelled to contribute toward its revenue unless he makes use of its service. The revenue from postage stamps in almost all countries roughly equals the expenses of conducting the business, and each individual user pays (again with a rough approximation) in proportion to the service which he gets. The same situation exists when a government manages the telegraph or the railway. But when it maintains streets, a fire department, a police force, it supplies the several services free to every one. On the other hand, it calls upon every one to contribute. It is immaterial whether he happens to be benefited directly or indirectly; a great deal, a little, or not at all. What one pays to the government for a postage stamp, for a railway ticket, for a supply of water, is in the nature of a price for a specific service. It is very different from a tax, which is exacted from all alike, and without any regard to the individual's use of the services supplied.

This severance of payment from service is sometimes inevitable. To tell how much any individual is benefited by the maintenance of order through a police force is impossible. The only way to support the force is to call upon every one to contribute, in some proportion deemed equitable. The same is true of a military force, whether regarded as a sort of enlarged police or as an instrument for national advancement in other

ways. Service for the maintenance of sanitary conditions is in the same case. It is conceivable, as to fire-fighting apparatus, that apportionment of the expense should be made among different owners of inflammable property on some well-defined principle of insurance premium. But it is obvious that the whole community is vitally interested in preventing conflagrations, and the support of this public service also takes place by the levy of taxes which disregard any question of special benefit.

In other cases, increasing in number as civilization progresses, the use of taxes instead of prices is not inevitable, but is the result simply of a growing conviction of the wide usefulness of the service. Highways, beyond the confines of cities or thickly settled spots, were in former times often managed on the toll principle; so were bridges. Those alone paid for them who used them, and paid according to the extent of the use. Hence their construction and maintenance were likely to be left in the hands of private persons, to be managed like any other business. As the conviction spread that freedom of movement was of general advantage, tolls were abolished on roads and bridges, and these means of communication were supported by taxes. The most striking illustration of such a change in general opinion is found in the modern attitude toward education. It is entirely feasible to conduct education as a private industry, or to manage it, if public, on a principle of payment in proportion to the expense incurred. But all civilized peoples believe it to be of vital importance that education should be supplied to all, and should be supplied, not on any basis of proportional payment, but in such way as to uplift and advance the community at large. No doubt, a motive even more distinctly altruistic enters, — a desire to equalize opportunities, to make the way easier for the great masses of the poor, to mitigate inequalities in possessions and income. Under the influence of these converging motives, education is made free; not only elementary education, but in more or less degree higher education as well. A great range of government activity

illustrates the growing consciousness of common interest and the growing influence of sympathy and altruism, — libraries, museums, parks, hospitals. It has been aptly said that the growth of those services which are supported by taxation measures a people's consciousness of common interest, — nay, its very progress toward higher civilization.

Taxation necessarily involves compulsory levy. People may be unanimous in the belief that it is in the common interest for a given set of services to be undertaken gratuitously for all; but the support of the services by voluntary contributions is quite out of the question. There have been occasions, in times of great national peril and of fervently aroused public spirit, when voluntary contributions have been an appreciable financial resource; but they have been rare and short-lived. Even in the most imminent danger, a steady and considerable revenue can be got only by compulsion. Hence the mien of the tax-gatherer is as stern under a self-governing democracy as under the most absolute despotism. Men's willingness to support public service does not grow apace with their conviction of the need of public service.

§ 2. The first question of principle in taxation has to do, therefore, with the mode of apportionment. In what manner determine how much the individual shall contribute toward defraying the various public services rendered gratuitously? Shall he pay simply in proportion to his income, or more than in proportion? On this question there are two fundamentally different answers, the one more conservative, the other more radical; the one maintaining the principle of proportion, the other that of progression.

The conservative opinion, maintaining the principle of proportion, is very simple. It proposes to call upon each person to pay in proportion to his income, and so to leave the relations between different incomes undisturbed. Let the rich pay more in the degree to which their incomes are larger, but in that degree only. The essential basis for this view is that the existing distribution of wealth should not be disturbed.

True, some people are more prosperous than others; some are rich, others are poor. But these differences are regarded as defensible, — nay, in the unqualified support of the existing social order, are thought to be in accord with the maxims of ideal justice. Since taxes must be levied, and since it is hopeless to measure either the cost of the public services rendered to any individual, or the benefits to him of the services, let all be treated alike, and let all be called on to contribute the same proportion of income. The social system thus remains equitable after the tax levy, as it had been before.

A somewhat different view, but one leading to the same result, is that the existing distribution of property and income should not be disturbed *by taxation*. If it is to be disturbed, let other machinery for doing so be adopted. This view implies neither approval nor disapproval of the gulf between rich and poor, but simple indifference or aloofness. The tax-gatherer, it is said, should not be distracted by having to consider such large and difficult social questions. His task, even in its simplest form, is troublesome enough: to devise ways of securing the needed revenue without arousing discontent beyond endurance. This may be described as the simply financial principle of taxation: according to which taxation should concern itself solely with the problem of raising the money for public expenses. It leads, like the view first described, to proportional levy and to the rejection of progression.

Still another "financial" principle of taxation may be noted; one that perhaps should be called the cynical principle. According to this, the essential task for the legislator is to get the revenue in such way as to cause the minimum of vexation and opposition. Any tax is good which brings in a large net revenue without causing much protest from the payers, or at least from those payers who have political influence. If, in a democratic community, high progressive taxes on the rich bring in substantial returns, without trouble in administration and without causing many voters to revolt, let them be

imposed. And, on the other hand, if taxes on an article consumed in great quantities, such as sugar or coffee, promise a large revenue, and can be levied by a hoodwinking process which prevents the masses from realizing the burden, let them, too, be imposed. "Pluck the goose with as little squealing as possible." This cynical view is hardly ever advocated in so many words; but a great deal of legislation rests upon it. Every finance minister has constantly to face demands for additional revenue, and also opposition from those whom he proposes to tax. The temptation is well-nigh irresistible to follow the path of least resistance. The very great part which indirect taxes on commodities play in the finances of all modern countries is explicable chiefly on this ground.

But the question of justice in taxation is at least ostensibly kept in mind in most discussions. A consciousness of it underlies the trains of reasoning, favoring strict proportion, which have just been stated, — both that which affirms the distribution of wealth to be now just, and therefore rightly to be left undisturbed by taxation, and that which simply would keep taxation disentangled from questions of social reform. Both of these opinions have the merit of facing squarely a truth which many writers on this much-debated topic have failed to face; namely, that the question of equity in taxation cannot be discussed independently of the equity of the whole existing social order.

The courageous advocates of progression base their views precisely on the ground that the existing social order is not perfect, and that taxation should be one of the instruments for amending it. Whether or no all inequality in wealth and income be unjust, such great degrees of inequality as the modern world shows are regarded as not consonant with canons of justice. Very rich persons should be called to pay taxes not only in proportion to their incomes, but more than in proportion. This proposal has been called socialistic; and it is, if all measures looking to mitigation of inequality be so called. Those who hold it place progressive taxation in the same class with

free education, factory legislation, regulation of monopolies, extension of government management, — measures all of which are based on a desire to improve the social order in the direction of less inequality. The extent to which they are willing to go with progression no doubt depends on the degree of their fervor for social reform in general; nor are they themselves able to give a precise answer to the question often asked, how far is progression to go? Their opponents have urged, to use a much-quoted phrase of McCulloch's, that when once you diverge from the rule of proportion, you are at sea without rudder or compass. The same difficulty might be urged against all sorts of movements for reform. Few except the out-and-out socialists have clear notions as to their ultimate goal. But it suffices for the average man to know in what direction he is moving. Most unsophisticated persons in the advanced countries of modern times, though they have very hazy ideas about taxation and socialism and economics in general, will instinctively declare it "right" that the rich should contribute to the public burdens, as compared with the poor, not only in proportion to their incomes, but more than in proportion. In so saying, they show that influence of the spirit of the time from which none of us can escape.

Sundry phrases have been used, embodying supposed principles of taxation, which fail to face this fundamental problem. It is often said that taxation should be based on "ability" (the Germans use the word *Leistungsfähigkeit*) or on "faculty." Yet it is by no means clear either that this principle conforms to economic justice or that it leads to any certain conclusion on the crucial point, — proportion or progression. No doubt, the rich man's ability to pay is greater than the poor man's. But does it follow that he should pay more heavily toward public charges? His ability to pay for bread and coal is also greater; yet we accept it as a matter of course, and as reasonable and just, that he should pay for them at the same prices as persons of small income. It is an open question whether this be really just, — whether the strong and efficient, the fortunate and

favored, should be in a position of economic advantage.[1] But such is the way of the modern world, under the régime of private property. Why, under that régime, should an entirely different principle be applied in regard to taxation? Can the principle of "ability" be declared abstractly just without maintaining also that our economic system is in general unjust?

In any case, the principle of ability, whether or no accepted as resting on a conception of justice different from that which underlies the system of private property, leads to no clear conclusion as to progression. Granted that the rich should pay on the basis of ability, the question remains, how is that "ability" to be measured? Does their ability increase in exact proportion to their incomes, or more than in proportion? Those who advocate ability or faculty as the just principle for apportioning taxes usually come to a conclusion in favor of progression. Yet their principle does not necessarily lead to that conclusion; unless, indeed, one feels that the rich in general are in an unduly favored position and that it is equitable to apply to public charges a different rule from that which holds in other affairs.

The same sort of difficulty, and the same inevitable harking back to the fundamental questions of social justice, arises from another phrase much used in these discussions; namely, that taxes should be so levied as to bring "equality of sacrifice." Unflinchingly applied, this principle would lead to high progression in taxation. Take away half the income of a poor man, and the sacrifice imposed on him is vastly greater than when you take away half the income of a millionaire. In the case of the poor man, taxation would exact what is essential for life or for meager comfort; in that of the rich man, only the means for luxury and ostentation. To bring about equality of sacrifice, you must take away a much larger proportion from the millionaire. But the fundamental question recurs: why equality of sacrifice here, when in other matters no such rule is followed? Efficiency, not sacrifice, is the dominant principle

[1] Compare Book VII, Chapter 64, § 3.

in existing distribution. To apply a principle of equality of sacrifice to problems of taxation (which can arise only in communities founded on individualism and private property) is to admit that the working of individualism is not to one's liking; that is, to undertake, in this regard at least, a change and a reformation.

§ 3. This same insistent question presents itself with regard to another much-debated point: whether permanent incomes shall be taxed at the same rate as temporary incomes. In the literature on taxation, the phrases "funded" and "unfunded" incomes are much used. Funded incomes are those derived from income-yielding property, and standing for interest or rent or established monopoly gains. Unfunded incomes are salaries, wages, business profits, professional gains. The former last indefinitely; the latter cease at latest with the lives of their holders. Should they be taxed at the same rate or at different rates?

The difference in duration between the two gives no solid reason for discrimination. If it be said that the funded incomes, because lasting longer, are really larger, the answer is that the tax, too, lasts longer. If the income lasts forever, the tax will go on forever. There is indeed, in one respect, a substantial difference in the weight of taxation: the holder of the unfunded income is in many instances under a moral obligation not to use the whole of his income, but to save some considerable portion. What he puts aside for the future use of wife or children, is virtually no part of his present income. It will become later a part of the income of the dependents. If it is taxed now, and is taxed again when it reaches the beneficiaries; or if, after it has been invested, an income from it inuring later to the beneficiaries is taxed in their hands, — then there is double taxation of the same income. The holder of a funded income may indeed do the same thing, and his savings also may become the occasion of double taxes; but he is not so likely to put aside part of his present income, since this passes on, presumably undiminished, to his heirs. On

such grounds countries levying an income tax often permit the deduction, from the amount *prima facie* taxable, of certain sums paid out for life insurance premium. The sums so allowed for are limited, and only unmistakeable savings out of income (evidenced by insurance premiums) are considered; precautions of this sort being necessary to prevent the mitigation from becoming a means of evasion. But the principle of lesser taxes on unfunded incomes is thus recognized, and recognized on the precise ground of not taxing such sums as are no effective constituents of present income.

The common practise, however, of taxing funded incomes at a higher rate hardly rests on this ground. It rests probably on the same attitude toward social problems as the common acquiescence in progressive taxes, — on a half-unconscious admission that justice does not call for identical treatment. Funded incomes stand for the leisure class, — for those who contribute nothing directly to the community's resources, but live on secure income-yielding possessions. The thick-and-thin defender of the existing order will indeed say that these incomes are as just as the incomes of those who now work. Interest and rent are as worthy and as defensible as any other sorts of income, and discrimination against them by higher rates of taxation is an unwarranted admission of lack of justification. The contention is as unanswerable as is the similar argument against progressive taxes on the rich. But most persons, though they do not formulate their conclusions with care or accuracy, feel that somehow incomes derived from labor do have a more solid justification, and that the leisure class incomes do stand on less defensible ground. It may be right that some fortunate individuals, and their descendants forever, should live in leisure, without doing a stroke of work. But this does not seem right in the same degree as "earning" your living. Hence, though complete confiscation of funded incomes, through taxation or any other machinery, would be condemned by the average man as "dishonest" or "socialistic," some concession to the critical and reforming spirit is made by approving higher taxes on

such incomes. Unless there be concession of this sort and on this ground, there is no logical ground for the general application of a higher rate of taxation on funded incomes.

§ 4. Any conclusion, then, in favor of progressive taxation and of higher taxation of funded incomes must rest, to be consistent, on a frank admission of unwelcome features in existing society and on a program of social reform. The only question, then, will be whether this particular mode of reform, through taxation, is likely to work well, whether it may not bring evils in its train, whether other ways toward the same end are not better. And here there are serious reasons for doubting the wisdom of such measures, and certainly for proceeding with great caution in their application.

Some difficulties of administration which stand in the way of applying progressive scales will receive attention presently. They vary with different sorts of taxes, as will appear on a consideration of particular levies. Let attention be given here to some questions of principle.

Progressive taxation, so far as it aims to correct unjustified inequalities, evidently deals with results, not causes. It is obviously better to go to the root of the matter, and to deal with the causes. Much the more effective and promising way of reform is to promote the mitigation of inequality in other ways, — by equalization of opportunity through widespread facilities for rational education, by the control of monopoly industries, by the removal of the conditions which make possible illegitimate profits. Progressive taxation, which deals with income (or property) solely according to size, and not according to social desert, is less discriminating and also less effective in reaching the ultimate goal than the various ways of spreading material welfare which have been considered in the preceding pages.

It may seem a simple matter to apply the principle of progressive taxation on the basis of the character of the income; to make the rates progressively high, not in all cases where the income is large, but in those cases where income is made large

in objectionable ways. The principle seems clear enough: are the inequalities such as are necessary to induce activity that is advantageous to the community as a whole? Given the institution of private property, with all the motives and ambitions which are part of it, and a great range of inequalities is in this sense advantageous. Interest is not to be dispensed with, nor that return for natural agents which is indistinguishably commingled with interest. Salaries, professional earnings, business profits in the strict sense, are inseparably associated with the exercise of their faculties by those who earn the incomes. The fullest activities are promoted by letting them earn all they can; and the greater the competition thus promoted between them, the more likely is it that the community will be amply supplied with useful services. Tax no such incomes on the ground of their size.

But to earmark the incomes thus "legitimately" large, and to distinguish them from the "illegitimate" incomes, is an extremely difficult matter. The law must deal with unmistakable facts; it cannot be based on general principles and rough approximations. But the conclusions of economic science, above all as to the great social questions, are essentially in the nature of rough approximations. What, for example, are "illegitimate" profits? How define them in such manner as to make them subject to special taxation? We may be certain that there are such gains, due to chicanery, swindling, browbeating of the weak and inexperienced. But how separate them sharply from the profits secured in ways advantageous to the community and in accord with its accepted standards of right conduct? To apply any sort of discriminating taxation, without bearing too hard on the springs of energy and enterprise, is impracticable. The only course open is to deal with the causes: to protect the weak, to elevate the plane of competition, to improve the law, to prosecute remorselessly the guilty.

Certain kinds of funded income are marked off more sharply as not essential for the working of the individualistic system,

and therefore peculiarly fit for taxation. Such are urban site rents, or rather those accretions of future site rents which are not protected by the principle of vested interests.[1] Monopoly profits are in the same class. Often, it is true, they are as difficult to define with the necessary precision as are "illegitimate" profits. How separate high gains due to enterprise and good management from those arising purely from monopoly? Yet there are cases when this can be done; as where a bank is given the monopoly of note issue, or a street railway or gas company the monopoly of serving a city. Then it is clearly proper to provide that profits above a given rate of return on the investment shall be divided with the state. The amount going to the state in such case may be entitled a "tax" or a "share." The name is immaterial; it is in essence a levy on a certain kind of income, justified by the principle of removing inequality which brings no offsetting social gain.

In general, however, progressive taxation is not practicable on the basis of the kind of income. It is susceptible of application, on a wide scale, only with reference to the amount of income. To many persons, this will seem no significant distinction. To tax an income large in amount will seem to them the same thing as taxing an income objectionable in kind. Though few would carry this sort of belief to its logical outcome, and condemn all inequality once for all, there is an instinctive feeling that great inequalities are bad and very large incomes peculiarly fit objects of taxation. The growth of social sympathy and all the prepossessions of democracy strengthen the hold of the principle of progression in its undiscriminating form. This state of mind, and the inevitable formulation of the law on sharply distinguishable lines, make it well-nigh certain that progressive taxation will have wider and wider application. The only question will be how far it shall go and what difficulties of administration it must encounter.

§ 5. Still another question arises with regard to differential or progressive taxes on funded incomes. It is concerned with

[1] Compare Book V, Chapter 44, § 5.

the application of progression, not according to the source or kind of funded income, but purely according to its amount.

The essential ground on which interest can be defended is that the return is necessary in order to induce accumulation. Saving is onerous and will not be carried on unless there is a return on investments. But we have seen that this is by no means the exact situation with regard to all savings. There are many infra-marginal savers.[1] As to these, the appropriation of part of their income by the state would not lessen accumulation. The same principle is applicable as in the case of rent proper. A tax on rent falls definitively on the owner, and has no further effects on the supply or the utilization of the source of rent. From this point of view there may be ground for progressive taxation of large funded incomes.

Those whose means are large almost always enjoy some "saver's rent." They may secure say four per cent on their investments; but they would maintain the investments intact in almost all cases, even though they got only two per cent. The capital sum being large, a comfortable income, perhaps a handsome income, would still be secured at the lower rate. Rather than forego this income, accumulation would be maintained, and capital would remain undiminished.

The same reasoning would apply, of course, in all cases where there is saver's rent. Those who save primarily in order to make provision for the uncertainties of the future, for old age, for wife and children, would continue to do so in large measure, even though interest rates were much reduced, nay, wiped out. The appropriation through taxation of a part of their income from accumulations would not cause a decline in social capital. But in these cases there is not commonly the degree of inequality which gives rise to the demand for differential or progressive taxation. Great inequalities, such as seem inconsistent with the democratic and equalizing spirit of our time, arise from the very large properties, which are hardly ever accumulated merely because of a desire to provide for the future. Social ambition,

[1] Compare Book V, Chapter 39, §§ 2-4.

the love of domination, the pride of achievement, ~~are the motives~~ of the creators of fortunes; social ambition, again, and the love of ease, are the motives which lead their descendants to maintain the fortunes. A lower rate of return would not cause impairment of their principal or a diminution of the sources on which the community's apparatus of production depends.

On grounds like these, progressive taxation of large funded incomes can be advocated; advocated, that is, if one frankly accepts the view that great inequalities in wealth are undesirable, and should be lessened, by taxation or other means, so far as other consequences equally undesirable for the community can be avoided. In this case, one possible undesirable consequence is a check to accumulation; but, on the strict theory of saver's rent, no check, in fact, is to be expected.

Still other possible undesirable consequences, however, arise in connection with the administration of taxes. Some sorts of taxes can be collected with facility and certainty. Others cause endless difficulties in attempts at evasion and in demoralization of the taxpayers. Income taxes more particularly cause such difficulties, and cause them in greater degree according as they are levied on a progressive scale. This aspect of the problem of progression will be considered in the next chapter.

CHAPTER 67

INCOME AND INHERITANCE TAXES

§ 1. In the preceding chapter the problem of justice was treated as if all taxes were paid out of income. And this in the end is the case: ultimately all taxes are derived from income. Though many taxes are levied in the first instance, not with respect to income, but with respect to lands or houses or commodities, these taxes fall eventually on some one's income, though not necessarily on that of the person first charged with their payment. There are, indeed, taxes which may conceivably cause a diminution not of an individual's income, but of his capital or his accumulated possessions. Such may be the working of taxes on inheritances. These, however, are effects not common in modern communities. There is no serious deviation from the truth in saying that all taxes are derived from income.

But though taxes are paid out of income, a comparatively small part of the public revenue is secured by direct levy on income. Some countries have no income taxes at all. Even those which have fully developed income taxes secure only a moderate fraction of their revenue from this source. Moreover, no country endeavors to tax all incomes directly. Income taxes *eo nomine* are confined virtually to the prosperous members of society. Most of those who earn wages by manual labor are not so reached. Their incomes are affected by other taxes only, and in ways of which, as a rule, they are but dimly conscious.

It follows that the problems of justice in taxation, dealt with in the last chapter, are to be considered with reference

not simply to those public levies which go by the name of income taxes, but with reference to all levies of whatever kind. The questions whether taxes should be progressive, or are in fact progressive, must be answered with reference to all the charges. It is entirely possible, for example, that income taxes should be progressive, yet the tax system as a whole not so. As will presently appear, a great many sorts of taxes in wide use are really regressive in their ultimate effects; that is, they bear more heavily, in proportion to income, on the poor than on the rich and the well-to-do. Under such conditions, it may be maintained without hesitation that taxes levied directly on the incomes of the latter should be progressive in order to secure simple proportionality for the tax system as a whole. Whether this is in fact the case for the tax system of a given country is extremely difficult to make out; so uncertain is the ultimate effect of many of the taxes commonly resorted to. But the very existence of the question, and the uncertainty of the answer, show that progression as to taxes levied directly on income is only part of a much larger problem.

None the less, the dispute concerning progression is specially active and often acrid concerning direct income taxes alone. It is so because here the question must be faced; whereas in the case of other taxes it is concealed and evaded.

§ 2. The limitation of income taxes to the comparatively well-to-do arises in practice from the fact that the trouble and cost of direct levy make it impracticable to reach small incomes. It costs at least as much to collect an income tax of, say, 2 or 5 per cent from a man having an income of $500 as from one having an income of $5000; it may very possibly cost more. The revenue in the one case is ten times as great as in the other. To collect from millions of workingmen a few dollars or a few shillings each would be perhaps not impossible, but almost ruinously expensive. If they are to be reached at all by taxation, some other way must be found. Hence there is exempted from income taxation in most countries a minimum

which is above ordinary working-class income and above the average income of the whole people. In England, incomes under £160 are exempt; in Prussia, incomes under 900 marks. In the United States, when incomes were taxed, during the Civil War period, only those over $600 were chargeable.

This limitation has often been explained and defended on social grounds. The poor, it is said, and those who have barely enough to live on, should not be taxed. Obviously, the minimum of subsistence should not be taxed; or, to speak more accurately, the attempt to tax it should not be made, since the very term implies that it cannot be reduced by taxation. When people talk of not taxing the minimum of subsistence, they commonly have in mind something as variable as the living wage. The demand for the exemption of the lowest tier of incomes results from the same state of mind as the advocacy of progressive taxation,—dissatisfaction with existing inequalities and desire to lessen them. Unfortunately, this feeling does not lead, so far as taxation is concerned, to any consistent results. Those who possess only the "minimum" or the "living wage," though exempted from direct levies on their income are in fact taxed, and often taxed heavily, in other ways. It is only when a proposal is made to reach them overtly that people balk, and insist on exemption. In the actual arrangement of the tax system, benevolent phrases of the kind cited are used to explain and justify exemptions which in fact are due mainly to the practical difficulties of reaching small incomes, and (in democratic countries) the fear of irritating millions of voters; whereas, notwithstanding the phrases, taxes which reach the masses in unobtrusive ways, are levied on a large scale with little apology.

Considered as a matter of principle, it is by no means desirable that the workingmen as a mass should not be subjected to taxes. Let the taxes be moderate, and even, if you please, degressive; that is, lower and lower in proportion as incomes become smaller. But there is no ground for the assumption

that the mass of workingmen in advanced countries have barely the "living wage," and should therefore be exempted. It is fit that they, too, should contribute toward the public charges. It is desirable, moreover, that they should not only pay, but should be conscious of paying. Much would be gained if they were not charged solely by veiled indirect taxes. Even though they paid sums but small in proportion to incomes, their point of view on public affairs would be altered. Too commonly, in democratic states, they are not conscious of contributing anything at all. Their attitude toward public business is simply that there is a great fund of money from which employment or largess can be got. They rarely regard taxation as an instrument for promoting the general welfare. And yet this unfortunate situation is extremely difficult to mend. Taxes levied in small sums are not only expensive to collect, but are irritating to the payers. The legislator who gets rid of them not only promotes administrative economy; he also gains popularity. Even so slight a levy as the poll tax (a fixed small sum, say $1 or $2 a year, on each male adult) is almost impossible to maintain. In some German states, it is true, such as Prussia and Saxony, the income tax system reaches far down. Incomes as low as 900 marks are chargeable in Prussia, as low as 500 marks in Saxony. But in these countries, the government, though it may be administered in good faith for the people, is not government by the people. The probabilities are that under a real democracy such minute levies will disappear even in the countries where they now persist.

§ 3. Bearing in mind that in practise income taxes are levied only on the comparatively small number of the well-to-do and rich, let us consider the two great types,—one of direct levy on each individual's total income, the other of levy on the several sources from which the income is derived. The direct method is best exemplified by the practice of the German states, among which Prussia is for this purpose the most instructive, as well as the largest. The other method, of which the salient characteristic is stoppage at the source, is exemplified by the prac-

tice of England. It will be convenient to examine first the British system.

The British income tax has sometimes been described as a series of taxes, in each of which a special method is adopted to attain the same end. Wherever feasible, the method is to reach the taxpayer's income, not after he has received it, but before. Thus, to take the simplest case, the government deducts from the interest which it pays on its own debt the amount chargeable as income tax. The holder of consols hence receives his income diminished by so much; thereby the tax has been collected. Every debtor, whether private person or corporation, is required to act, in substantially the same way, as a sort of agent for the government in collecting the income tax from creditors. Every debtor pays tax on his full income, irrespective of his being burdened by debt and by an interest charge. But when he pays the stipulated interest to his creditor, he is entitled to deduct the amount (say 3 per cent — whatever the income tax rate may be) chargeable as tax. The creditor receives 97 per cent of what would otherwise have been his due, and thus his income has been reached. And, to prevent possible failure of the system to work out this result, "contracting out" is made void; it is provided that no agreement between debtor and creditor by which the latter is to receive his interest without income tax deduction, shall be valid. The unrestricted self-interest of the debtor is thus brought to bear toward the collection of the tax from the creditor. In this manner the income tax is secured in regard to all bonds or debentures issued by British corporations; the corporations pay the full tax on their net receipts, but deduct the proper quota from each bondholder's income.

As regards another kind of income often difficult to reach,— dividends on stocks,—the same principle is followed, and, as regards British corporations, is followed with ease. The corporations are simply taxed on the whole of their income, and the stockholder bears the tax in that the net earnings from which his dividends arise are diminished by so much. The com-

parative publicity with which the affairs of corporations are conducted, especially of large corporations, is a strong preventive of fraud in their statements of earnings, and facilitates the efficient collection of the tax.

Again, as regards income derived not from British debtors or British corporations, but from foreigners, the principle is also followed so far as practicable. Such income is a large item in Great Britain, whose people have great investments in foreign regions. But these investments are commonly arranged and managed by bankers or other financial agents, who often act as agents for the remittance of interest or dividends to the individual investors. When they so act, they are required to pay the income tax on what passes through their hands, deducting the amount from what is payable to their clients. In this way a surprising amount is reached. Evasion or concealment is virtually impossible, since it would require collusion between the agent and the scattered clients. Obviously, the method is inapplicable where remittances are made, not through a British banker or agent, but from foreign parts direct to the individual investors. In such case the only way to reach the income is to levy on the investor himself, calling upon him to make a declaration of this income.

Income from land and real property is always reached with comparative ease in any tax system; for land and houses cannot be concealed, and the income they yield is not difficult to ascertain. In the English system the occupier of real property is liable for income tax once for all on the rental value of the premises occupied by him. If he is owner, this ends the matter; he has paid income tax on what as owner and occupier he enjoys. If he is tenant, he is entitled to deduct from the rental payable to the landlord the income tax on that sum, and the landlord thus finds his tax deducted and paid. Here, as in the similar relations between debtor and creditor, "contracting out" is made void.

Salaries whose amount is such as to make them subject to income tax are also reached by stoppage at the source. The

employer is called on to pay the tax, and deduct the amount from the stipulated salary.

Enough has been said [1] to show how far-reaching is the method of stoppage at the source. There are, indeed, some incomes which cannot be so reached. The professional earnings of lawyers, physicians, and the like; the incomes of business men, whether shopkeepers or great manufacturers (so far as the incomes are not secured in the form of dividends from corporations of a semi-public kind); returns from foreign investment which do not go through a British banker's hands, — these cannot be tapped at the source. Here some other method must be resorted to, — declaration of income required from the taxpayer or inquiry instituted by the tax collector. But much the greater part of the income chargeable with tax is reached without personal declaration or obtrusive inquiry. Three quarters of the British tax is collected without a word of inquiry or a possibility of evasion.

It is obvious, however, that this system does not lend itself easily to progression in the taxation of incomes. There is indeed a device for making the tax degressive; that is, for lowering it on modest incomes, and for exempting small incomes entirely. As was noted above, incomes under £160 are exempted from the British tax. It may easily happen that a person whose total income is below £160 may find that his income has been taxed through stoppage at the source. He then applies to the tax authorities, declares his income to be below the taxable limit, and receives back in cash what has been reached by stoppage at the source. The same method is applied in alleviating the tax on modest incomes, up to £700. These are entitled to an "abatement," varying by gradations according to the size of the income. The possessor of an income in this range, if he has been reached by the machinery of stoppage at the source, also makes a declaration to the tax au-

[1] This sketch is by no means designed to give a full account of the English income tax; only so much has been said as to make clear the importance of stoppage at the source.

thorities, and is entitled to reimbursement to such extent as will abate his income tax to the extent contemplated by the law.[1]

But, to repeat, the principle of stoppage at the source is not consistent with progression. A person of large means pays income tax, or rather finds that income tax has been paid for him, in a number of ways, — by various deductions from his rent, interest, or dividends. He is never called on to declare his total income. Only that income which has not been taxed before it reaches him, must be directly ascertained by the tax authorities. Doubtless, there are persons whose entire income must be directly ascertained, such as small tradesmen, some lawyers or physicians, possibly investors in foreign property. But almost every person having a considerable income need make declaration of only part of it, — very likely of no part at all. The smoothness, ease, and certainty of the method of tapping the source are inconsistent with the endeavor to ascertain in one lump the income of each taxpayer; and without this there can be no application of progression.[2]

[1] Under the English income tax legislation, as remodeled in 1898, incomes up to £160 are exempt; incomes between £160 and £400 are entitled to an abatement of £160; and other incomes are entitled to abatement thus: —

Incomes	*Abatement*
£400 @ 500	£150
£500 @ 600	£120
£600 @ 700	£70

The full rate of tax, consequently, is levied only on incomes exceeding £700.

In 1907 the method of abatement was also applied to making the rate of tax lower on "earned" incomes (from salary, profession, business, and the like) than on "unearned" or funded incomes. Here, again, the person who wishes to secure the benefit of the lower rate must establish his right to abatement by making a statement of his total income. The general income tax rate was fixed for 1910 at 1*s*. 2*d*. in the pound. A person whose total income (from all sources) was under £2000, was entitled to abatement so as to reduce his tax to 9*d*. in the pound; one whose total income was between £2000 and £3000, to abatement so as to reduce his tax to 1*s*. in the pound.

[2] The English income tax is levied at rates varying from year to year. Usually the rate in recent times has been from 8 pence to 10 pence in the pound. Its maximum in the 19th century was (in 1855–1856) 1 shilling 4 pence, or 6⅔ per cent. During the South African war it went (in 1902–1903) to 1 shilling 3 pence. On the outbreak of the great European war in 1914 the rate was raised to 2 shillings 6 pence, *i.e.* 12½ per cent.

Notwithstanding the administrative advantages thus secured by refraining from the attempt at progression, the British income tax has been remodeled in very recent years precisely in the direction of progression. There can be no stronger evidence of the strength of the general drift toward legislation that is hostile to inequality. In 1910, the same budget that introduced taxes on the rising value of urban land established also a "super-tax"; that is, an additional tax on very large incomes, exceeding £5000 a year. Such an additional tax, of course, cannot be collected without ascertaining the total incomes of all who have incomes of this amount, or are supposed to have. Thereby the income tax officials are compelled to face a new and difficult problem. They must secure declarations of income from many persons, with all the difficulties of evasion, concealment, fraud, which this endeavor necessarily brings. No doubt, the task is not so serious as it would be if a progressive scale of general application were established. But it is serious enough, even when limited to the incomes over £5000.

§ 4. Turn now to such an income tax as that of Prussia, a well-administered progressive tax, the model which the countries of Continental Europe are tending to follow. The progression is moderate, the rate rising from less than 1 per cent on small incomes to 4 per cent on incomes exceeding 100,000 marks. Necessarily, the whole of each taxpayer's income must be ascertained. This might be done in two ways, — by assessment on the part of the authorities, or by declaration required from the taxpayer. Assessment without declaration means more or less of guesswork, and, especially in the case of larger incomes, great inequalities, often glaring discrepancies. Experience has proved that without some sort of declaration no tax of this kind works as it is designed to work. Hence, in Prussia, declarations are required, — required not only nominally, but in the actual administration of the tax.[1]

[1] In our American states, declarations from taxpayers are required by the laws for the property tax (see below, Chapter 69). But the requirement is in practise rarely enforced; the tax is levied by estimate, *i.e.* guesswork on the part of the officials. Foreign students who look to the letter of American tax

Declaration, however, brings difficulties of its own. The amount of the levy is made to depend on the taxpayer's own statement. The temptation to evasion and deceit is patent. Penalties for failure to make a statement, or for false statement, are not easy to enforce. There is constant danger of demoralization among the taxpayers, of easy-going connivance among the officials, and so of failure to attain the essential object, — the precise adjustment of the progressive scale to actual incomes. In their working, income taxes have too often been a byword and a reproach.

The difficulties do not arise merely from evasion and dishonesty. They rest in large part on a resentment against intrusion on what are supposed to be private affairs. Many a man who will cheerfully pay a substantial tax on his income is unwilling to submit to prying eyes a detailed statement of that income. The social philosopher may indeed say that this is an irrational frame of mind, nay, is something like a confession of doubt as to the justification of the income. If it is right that one should have a large income, why conceal at all its amount or its source? But men's ways, as they have developed in the centuries during which the acquisition of property has been a goal of ambition, are not so simple as this question implies. A strong instinct of privacy has extended to the possession of property and income; it is present, whether rational or not; and it is violated by a requirement of full statement, most of all by the chance of wide publicity.

These various difficulties are not insuperable. An honest, well-trained, experienced staff of officials, and a well-framed tax system, can meet them with sufficient success. Declarations need not be required in minute detail, nor need they be opened to public inspection. Some degree of publicity is probably necessary as a safeguard against false statements; but it need not be publication to the world at large. It suffices if a select

statutes are entirely deceived as to their working. In no department of government is it more necessary than in matters of taxation to examine, not the letter of the law, but its actual operation. In Prussia, as the text states, the requirement of declaration is enforced.

body of local persons of experience, judgment, and established position, are enlisted to advise and coöperate with the permanent administrators. These advisers must be persons who are likely to know something of the probable incomes of the several taxpayers, and before whom they would not wish nor dare to make statements grossly false. A device of this sort is used in the Prussian system, and is used also in that part of the English system for which declaration must be resorted to. To go into the details of the several methods would pass the bounds of a book like the present. Suffice it to say that with a proper permanent staff of capable and tactful officials, with a steady requirement of declarations, with supervision and inspection not carried to the stage of universal publicity, income taxes, even though progressive, can be administered successfully. Not a little depends, to be sure, on the amount of the tax. The higher it becomes, the greater is the danger of evasion, the greater the difficulty of preventing demoralization.

§ 5. Inheritance taxes present administrative problems somewhat different from those of income taxes. Progression is easier of application. At the same time, the question of principle, — is progression right? — presents itself more sharply.

The transfer of property at death must be subject to supervision by a court, or an administrative bureau resembling a court, to prevent contention or fraud among those who may lay claim to the property. Hence in all civilized countries the making of wills is carefully regulated, and probate officials or judges have unlimited powers over the winding up of decedents' estates. Their powers are exercised directly on the persons charged by law with the distribution of the estates, — the executors or administrators. This gives a convenient opportunity for collecting a tax. The executors and administrators are called on to pay the taxes, and not released from their obligations until they have given proof of the payment. Evasion of such taxes, if they are carefully arranged, is not easy. The tax statute can be drafted in such a way that the net is

tight. Change of residence may indeed be tried, to another jurisdiction where no such taxes are in force. This mode of evasion is obviously possible as regards the several states of our Union, since it is probable that some among them will not levy inheritance taxes, or will levy them only at low rates. But the more widespread are inheritance taxes, the less is there opportunity for a convenient change of residence. Gifts made during life, especially to children, constitute another mode of evasion. They are commonly made subject to tax on the same scale as inheritances; but a more effective obstacle than such legal equivalence is the reluctance of property owners to part with their own, even to their nearest and dearest. All the various possible means of evasion are of course likely to be resorted to in proportion as the rate of tax is high, most of all that of gifts *inter vivos*. Here, as with many other kinds of tax, a moderate rate is apt to be more effective in practise, more really equable, more productive of revenue, than a higher one.

All these, however, are matters of administration and detail, highly important to the legislator and to the special student of finance, but not of vital consequence for the principles involved. In general, it may be assumed that there are no insuperable obstacles to the effective levy of inheritance taxes, — less obstacles, in fact, than are met in income taxes. On what principles should they be framed?

The argument and the sentiment in favor of progression are especially strong. The inheritance of fortunes, the perpetuation through all time of conspicuous inequality by the accident of birth, the grave doubt whether effortless acquisition and enjoyment of fortunes promote the best happiness of the very beneficiaries, the moral scandal of the mode of living among many of those born rich, — all strengthen the *prima facie* objections to great inequalities in wealth. If the tax can be levied without serious administrative difficulties (such as make high progression of doubtful expediency as to income taxes), there can be no consistent argument against progression in

communities which try in all sorts of other ways to mitigate inequality.

On the other hand, there stands the essential ground on which the institution of inheritance rests. It is the great engine for the maintenance of capital. So long as private property dominates the industrial order, the maintenance and increase of the community's capital depend on the doings and motives of individuals in dealing with their property.[1] Inheritance, then, cannot be struck at its roots without checking accumulation and investment, and so doing damage greater than any consequent mitigation of inequality could offset. Some offshoots, doubtless, can be lopped without substantial harm. Moderate taxes on inheritance may not lead to a diminution of capital. They may be paid gradually out of income. But unless kept within moderate limits, they mean in the ordinary course of events diminution of individual capital and of social capital.

The only ground on which heavy direct inheritance taxes can be said not to press harmfully on the maintenance and increase of capital is that in modern communities accumulation takes place at a prodigious rate. So vast is the savable fund, so increasingly strong are the motives which lead to saving, that something can be diverted from the stream without seriously lessening its volume. Evidently the question here is one of degree. The inflowing accumulations will, no doubt, remain enormous, even though moderate deductions be made from ordinary estates, and substantial amounts withdrawn from the small number of very large estates.

Evidently, considerations as to the motives for saving and bequest have little weight where there are no descendants or near relatives. The powerful motives for accumulation and transmission to heirs or legatees are family love and pride. In collateral inheritances, or bequests to strangers, these play no part. Hence taxes can be reasonably levied in such cases at a higher rate than in case of direct transmission. That they are, in fact, commonly levied at a higher rate results, doubtless,

[1] Compare Book V, Chapter 54, § 5.

from a somewhat vague sentiment that it is "right" for a wife or a child to succeed to an undiminished property, while no such "right" exists when bequest or inheritance brings a windfall to a distant relative or a stranger. The economic difference between the two cases is that in the one transmission to the heirs or legatees presumably has been a motive for accumulation, in the other presumably not.

§ 6. Inheritance taxes are not equal in their effects — that is, do not bear equally on all taxpayers in similar circumstances — unless they are maintained at the same rates for a long period. Given time enough, and all estates must run the gantlet. But if the rates are changed at short intervals, some successions will pay at one rate, while others of precisely the same amount and kind will pay at a different rate. Hence this form of taxation should not be resorted to in order to meet temporary financial needs. During the war with Spain, the United States levied in 1898 inheritance taxes, varying (according to the size of the estate and the degree of relationship) from $\frac{3}{4}$ of 1 per cent to 15 per cent. Shortly after the war, the revenue being redundant, these taxes were repealed (1901). The estates of those who happened to die within these three years were subjected to the tax; but a vastly greater number never were. Such legislation violates the first and simplest canon of taxation, — that of equality in levy on all persons in like circumstances. It can be justified only in case of financial stress so great as to compel resort to every possible source of revenue.

The most developed system of inheritance taxes is that of Great Britain, where the rates (as consolidated under the legislation of 1894) range from 1 per cent to 10 per cent. The highest rate on estates going to direct descendants is 8 per cent, levied on estates exceeding £1,000,000. On large properties going to non-relatives, the highest rate is 18 per cent. Of late years many of our American states have established inheritance taxes. Sometimes these are on collateral successions only, but there is an increasing tendency to reach direct successions also, even though at a lower rate. Thus

Massachusetts has taxed (1912) direct successions from 1 to 4 per cent (according to the size of the estate) and collateral successions from 2 to 8 per cent. Wisconsin, to give another example, has taxed direct successions 3 per cent, and has reached a rate as high as 15 per cent on large successions (over $500,000) to non-relatives. This form of taxation has been left to the several states in our country, for the simple reason that their financial resources are not so varied and rich as are those of the general government. The federal inheritance tax of 1898, just referred to, was speedily repealed, and the way thus left free for state taxes of the same sort. These have been levied already by most of the states, and are likely to be resorted to sooner or later by all of them.

Income taxes, unlike inheritance taxes, are peculiarly fit for readjustment from year to year. If they are raised in one year, all incomes bear the extra burden; if lowered another year, all get the benefit of the reduction. Hence in Great Britain the income tax is used as a means of keeping the public receipts adjusted to the expenditures. It is raised in times of financial stress, and lowered in ordinary times. Obviously, it is a necessary part of this policy that in ordinary times the tax should not be pushed to the maximum which can be safely exacted. A margin must be left for emergencies. The British rate in peace had been not far from eight pence (3⅓ per cent) during the nineteenth century; it went to two shillings six pence (12½ per cent) after the outbreak of the great European war in 1914. In Prussia, also, the income tax is used as a flexible levy, but flexible rather for local than for state purposes. The Prussian local bodies (cities and communes) secure a large part of their revenues by subjecting the income taxpayers to an additional tax for local purposes; they simply add "supplements," or percentual additions, to the state income tax. The supplements vary from year to year, and vary in different places, as financial needs are greater or less; and they are large, rising to 150 and even to 200 per cent of the state tax. In consequence, the total tax on an income in Prussia is two or three

times the state levy, and the total rate is so high (10 or 12 per cent on large incomes) as to seem to leave little play for further additions in cases of emergency. In this respect, Great Britain has used her income tax more skillfully.

§ 7. In the United States constitutional obstacles stood for a time in the way of a federal income tax. Such a tax had been levied and collected, it is true, during the Civil War; but when levied again at a later date (1894), was held not to be valid. This question was set at rest by the income tax amendment to the Constitution (1913), which gave Congress a free hand. In the revenue act of 1913 advantage was at once taken of the authorization by levying a general tax on incomes.

In one respect conditions in the United States are peculiarly favorable for the application of the method of collection at the source. There is comparatively little investment outside the country. It is feasible to intercept at the source income from almost all stocks, bonds, and the like. Income from real property, which is reached in Great Britain by the same method, might be similarly treated; yet here there are difficult administrative problems, and, not least, a danger of real or apparent conflict with the states and local bodies which derive their tax revenue chiefly from land. Stoppage at the source is most readily applicable to the sort of funded income just mentioned, and tc salaries and the like fixed payments.

A half-hearted application of stoppage was made in the income tax of 1913. By this a "normal" income tax of one per cent was levied on all incomes above a certain minimum; the tax, it should be noted, being not on the entire income, but on the excess over the minimum. The exempt amount was unduly high, — $4000 for a married person, $3000 for one unmarried. The "normal" tax, thus seriously restricted, was collected to some extent by stoppage at the source. It happened that an earlier act had levied on corporations a tax at the rate of one per cent on their net income. This was retained, and was deemed to constitute a tax of one per cent on the shareholders' income; hence it was not necessary to make any further effort to call on

shareholders for the "normal" levy. As regards bondholders, the corporation or other body issuing the bonds paid the tax, and was to deduct the amount from the interest due to bondholders. To meet the cases of bondholders whose total income was less than the exempt amount, an arrangement was provided for declarations by them and for a virtual abatement of the tax. The administrative provisions for securing this abatement were cumbrous; indeed, what may be called the technique of the measure was in many ways unsatisfactory. There was ground for criticism of the taxation of bondholders not only as regards these administrative matters, but on a matter of principle also. All bonds of one great class — those issued by states, cities, and other local public bodies — were completely exempted from the application of the tax. The favored treatment was due to a notion that the taxation of such securities operated to limit or restrict the financial operations of the governmental bodies; whereas in fact, so long as these were treated precisely like others borrowing through bond sales, they were in no worse or better position than they had been before. No sound reason existed for the discrimination in their favor.

On other incomes — such as those from salaries, from professions and business, from real property, — there was reliance in the main on declaration by the taxpayer. It is true that stoppage was expected for some single payments that exceeded the exempt minimum; for example, when large rentals were paid in a lump sum for a given piece of real property. But there was no such consistent policy of applying the method wherever possible as characterizes the British income tax. Nor was there careful provision as regards the declarations required of taxpayers.

Quite different was the second part of the income tax: the "additional" tax, simpler in plan and scope than the "normal" tax just considered, but quite as difficult to administer. The additional tax was a progressive tax on large incomes. Persons with incomes up to $20,000 were subjected to the normal tax only; those with larger incomes, to the additional and progres-

sive tax.[1] Necessarily, this could be assessed and collected only with reference to the individual's income as a whole. The effectiveness of the tax depended on success in getting on track of all the persons liable and in procuring from them full declarations.

The machinery provided for this difficult task was crude; nor was it possible to predict with what results it would be put into operation. The insertion of the progressive feature in a measure which confessed, by its partial resort to stoppage at the source, the difficulties of income tax legislation, was still another proof of the strength of the tendency to repress and curb great inequalities of income. But a policy of this sort requires in every direction, — in the regulation of industry and in labor legislation, as well as in taxation, — care and skill in devising the laws, as well as a staff of trained high-minded administrators; and it can not be said that these requirements were met.

Nevertheless, taxation of incomes by the federal government has come to stay. It is probable not only that such a levy will be a permanent part of the revenue system of the United States, but that the rate will become higher and that the progression will be accentuated. Fiscal exigencies will not fail sooner or later to lead to a rise in the rate; and the growing spirit of social readjustment will cause the progression to be more marked. That same spirit, as well as eventual fiscal need, may bring about — what is much to be desired — a reduction of the exempt minimum and a reaching down of the tax to a somewhat deeper social stratum.

[1] The following statement summarizes the rates at which "normal" and "additional" taxes were levied by the act of 1913:

On the Amount by which Income exceeds	Normal Tax	Additional Tax	Total Tax (on the excess)
	Per cent	Per cent	Per cent
$4000 (or $3000) up to $20,000 .	1	—	1
20,000 up to 50,000	1	1	2
50,000 up to 75,000	1	2	3
75,000 up to 100,000	1	3	4
100,000 up to 250,000	1	4	5
250,000 up to 500,000	1	5	6
500,000 ———	1	6	7

CHAPTER 68

Taxes on Land and Buildings

§ 1. Taxes on real property — land and buildings — play a large part in all modern tax systems. For long periods in the history of European countries they were almost the only taxes; since real property was the only sort of wealth which could be effectively reached. The taxes which now exist in the older countries of Western civilization are largely survivals or descendants from such taxes of older days. They even descend, in a sense, from the dues of the feudal system. But they have been transformed and reshaped, and they now retain their important place in financial legislation for the simple reason that land and buildings are on the spot, cannot be moved, and their owners must submit to whatever tax is imposed on them.

Let us consider first the effects of the taxation of land by itself, — of land irrespective of any changes or improvements made by man. For the purpose of considering this case, let us suppose an urban site of great value, not improved by man, or improved so slightly that the important and effective element in its value is the land *per se*. Not infrequently, in our American cities, a lucrative central site is occupied by a one-story flimsy shop, used for retail trade and commanding a considerable rental, — one very high compared with the cost of erecting the building. This sort of utilization of the site is but temporary, due to hesitation on the owner's part as to when and how to secure the full economic rent of the site; or due possibly to uncertainty in the legal title and consequent unwillingness on the part of any one to make improvements. Not uncommonly under these circumstances a cheap dramshop is erected, because such an establishment is most sure to yield a good

rental, irrespective of the neatness or attractiveness of the building itself. Assume now that, for whatever reason, a valuable site is in this state. According to our American practise, it will be taxed on its full selling value as it stands, — for a large sum as regards the land, a small one as regards the building. The total tax, at such a rate as is now common in our cities (say 2 per cent on the capital value), will very possibly be greater than the whole rental secured from the shop. Who would bear such a tax?

The owner would gladly shift it to the tenant, by charging him a higher rental.[1] But clearly the owner cannot do so. Presumably the tenant is already charged with a rental commensurate with the profit-yielding possibilities of the site as it stands. The owner from the outset will exact all that can be got. The tax will enable him to get no more. Nor would a reduction in the tax cause him to be content with less; he would still demand and secure all that the site was worth. The tax falls definitively on the owner.

Such is the general proposition to be laid down with regard to taxes on land *per se*. They fall on the owner once for all. They operate as so much diminution of rent. In the extreme case, a tax equivalent to the full rent of land can be exacted, without any other effect than that of depriving the owner of his income. If a greater amount is assessed, the land, of course, will cease to be used; the owner and occupier alike will abandon it.

This proposition rests on the assumption that land is "rack-rented," — that the owner exacts in rental as much as he can possibly obtain. Such is not necessarily the case. Through ignorance or carelessness, he may let a tenant have it for less than might be got by the sharpest bargaining. In a country like England, agricultural land is owned and managed for the satisfaction of social ambition as well as for immediate pecuniary return, and is not infrequently let to farmers on indulgent

[1] In this chapter I use "rental" to signify what is paid by tenant to owner for a parcel of realty; "rent" in the sense of economic rent.

terms. Under such circumstances an additional tax levied on the landholder will probably lead him to look sharply at his rentals, and to take in all the slack. There is much discussion in England at present on the expediency of taxing ground rents; that is, of making a direct levy on the owners of sites. Those who advocate the measure lay it down with confidence that such a tax will affect the owners only, and will neither affect tenants nor raise the price of the articles produced (or sold) on the premises. They are right, — provided that the land is already rack-rented.

Consider now the operation of such a tax if it has been long imposed at the same rate, and seems certain to continue indefinitely. Any one who thereafter purchases the land will allow for the tax, and will pay a price based on its net return after the tax has been paid. This later purchaser will feel no burden from the tax; hence some persons are led to speak of this as "burdenless" taxation. It is burdenless, at the later stage, simply because the first owner has borne the burden once for all. In effect, a special permanent tax on his site amounts to the appropriation by the state of so much of the value of the site. Such appropriation may or may not be wise, — this raises the whole question of the ground for private property in land and for the private title to economic rent. But the tax is burdenless only if it has prevented some part of the economic rent from ever getting into any individual's hands. And this, to be sure, is the case where a substantial tax on an *ad valorem* basis has been continuously levied on land.

These principles hold good of agricultural land as well as of urban sites. A tax on strictly economic rent in either case falls on the owner. We have seen that in the case of agricultural land it is peculiarly difficult to draw the line between the rent of land proper and the return on capital invested in the land; [1] and for that reason the effect of a tax on agricultural land is in practise not so easy to follow. Yet there can be no doubt that there is a vast amount of land in old countries, and

[1] See Book V, Chapter 42, § 5.

in the older parts of new countries, which is above the margin of cultivation and yields some rent; and to all such land the propositions regarding the effects of a tax hold good.

§ 2. Taxes on buildings present a different case. Buildings may be taken as typical of improvements on land, or capital embodied in the land. The case of buildings is instructive, because it is comparatively easy to draw the line between the land itself and the capital invested in it.

Suppose a situation removed as far as possible from that considered in the previous section. Suppose a building erected on land whose value is negligible. Such, for example, are dwellings on the extreme edge of cities or suburbs, or factory buildings in small villages or in the open country. The familiar "three-decker" of New England is often of this sort, — the three-story wooden apartment house, occupied by mechanics and other prosperous workingmen, in suburbs and outlying districts.

A tax imposed on such a dwelling tends to be borne by the occupier. If the owner is also the occupier, the situation is simple enough; the burden clearly must be borne by him. But if, as is commonly the case, the dwelling is let and is built with the expectation of letting, the burden is likely to be shifted to the occupier (tenant) in the shape of higher rental. The building will not be put up unless the owner has reason to believe that the rental will yield him the current return on investment, and will yield that return *net;* that is, after payment of all expenses. Taxes are reckoned by him among the expenses. If a net return of five or six per cent is looked for, the rental will be expected to yield a gross return of eight, nine, or ten per cent. The difference covers depreciation, expenses of management, repairs, insurance, and — not least — taxes. If all taxes were remitted, — if the public revenue were secured in entirely different ways, — competition between house owners and house builders would bring rentals down. And, conversely, if taxes were to be greatly increased, house owners and house builders

would sooner or later recoup themselves for this higher expense by charging higher rentals.

This would be the result in the long run. It would not necessarily or even probably appear over short periods. The proximate cause determining rentals is the supply of house accommodations in its relation to the demand. A remission of taxes would not necessarily lower them at once; this consequence would ensue only after the greater return to the owners had stimulated an increase in the supply of houses. Minor changes in the tax rate — a bit of an increase one year, a decline in another — would not change them at all. The owners alone would be affected, grumbling loudly in the one case, in the other enjoying the remission in quiet.

There are circumstances under which the shifting of such taxes would not take place at all. In a city whose population is declining, house rentals are governed solely by the principle of quasi-rent. The houses are there, and cannot be removed. The cost of erecting them and the ordinary rate of interest on investments have no influence on their return. The question is simply one of an existing supply in relation to a declining demand. An increase of taxes in such a place would not cause rentals to go up; the owners would have to pay the taxes out of their own pockets once for all. After a very long time, a readjustment would doubtless take place. Houses do not last forever. As some wear out and disappear, new ones will not be built in a decaying town to replace them. Given time enough, the process of shifting taxes will indeed work itself out. But the time required may be long, — generations, or even centuries. The same situation may develop in a particular part even of a growing city. Some sections may come to be out of favor; fashion or convenience may cause people to move elsewhere; and then the houses in the half-abandoned sections will be in the same position as all the houses in a declining town.

But in a rapidly growing city the process of shifting takes place, not indeed with mathematical exactness, but in the long

run with considerable certainty. Houses will not be built for letting unless this is worth while; and it will not be worth while unless the owners get the current rate of return over and above taxes. The increasing demand for house room due to growing population will not be met unless rentals are high enough to make good the owner's outlay for taxes. Such is the common case in our American cities. Indeed, it is the case in most cities of the Western world; for the phenomenon of urban growth has shown itself in almost all countries. Taxes on buildings tend to be borne by the occupiers.

What holds good of dwellings, holds good also of buildings let for business purposes. Here also, if we fasten attention on a case where buildings alone figure in the capital account, it is obvious that taxes add so much to running expenses, and must be recouped to the investing owner in order to induce him to erect the building. Here, also, the principle of quasi-rent must be borne in mind. A business structure once put up is there for good, and its rental depends not on the expectations and calculations of the owner, but on the supply of this particular sort of accommodation in relation to the demand, — on the adaptability of the premises and on the growth and prosperity of the city. In a decaying town, or for obsolescent kinds of buildings, rentals will tend to decline in any case, and the owner will find no possibility of shifting his taxes to a tenant.

In the case of business structures, a still further process of shifting is probable. Just as the investing owner regards taxes as expenses, and expects to be recouped for them in his charges, so the business occupier regards his gross rental as an expense, and expects to be recouped for it in his profits. This is most obviously the case in retail dealings, where rental of the premises may be a large part of the total expenses of the tradesman. High charges for premises (that is, for buildings — not high ground rent) will mean higher prices for the goods sold, and the effect of higher taxes will tend to be somewhat higher charges on the community at large. Taxes will be very widely shifted and diffused; that is, they will tend to be so diffused in the long

run, if competition is active in the particular business, and if business profits conform to their normal range.

§ 3. The common case, as to urban realty, is not that land alone or buildings alone stand for the greater part of the capital value, but that each enters as a substantial part of the total. In the heart of a great city, the site will stand for more than the buildings, even though these be substantial and expensive. In outlying districts, the buildings will represent the larger part of the selling value; yet the land still counts. Now, according to the distribution between these two constituents, the incidence of taxes will be different. That portion of the tax which is levied on the selling value (the capitalized rent) of the site, remains definitively as a tax on the owner. That portion which is levied with respect to the building tends to be shifted to the tenant. Here, as in the previous section, we must have in mind the long-run operation of the taxes. The immediate effect is commonly that the owner bears the burden. Every parcel of real property yields proximately a rental fixed by its serviceableness, and not directly affected by taxes. It is only by affecting the supply of buildings that taxes on them tend in the long run to be shifted to tenants.

The long-continued levy of taxes on a site, at the same rate, brings about, as we have seen, a decline in the selling value of the site. So much of the economic rent has been appropriated by the state. The effect of taxes has not been to raise ground rents, but to lessen the net return to the owner. Where the site is highly valuable, a tax at the rates now common in American cities — say 2 per cent on the selling price — means the appropriation by the community of a very substantial part of the economic rent. And where the value of land is rising, taxes rise in proportion, and some slice of the unearned increment is steadily going into the public treasury. If it were not for the taxes, the net yield of the sites would be so much greater, and their selling price correspondingly higher. The high value of land in our large cities is thus a source of much revenue to the taxing body (that is, usually the city), and at the same

time of a revenue hardly felt as a tax by any one. It simply prevents the rent of land and its value from rising even higher; and since this is foreseen and expected by every one, no purchaser suffers. And evidently the same result would ensue if the whole of the future rise in value were absorbed in taxation.

The large and constantly growing revenue from this source, even at the present rates, accounts in no small degree for the extravagance of American municipal government. The business districts of New York City, for example, are a vast treasure house for the tax collector, as they are also in even greater degree for their owners. The enormous revenue collected from them in taxes makes possible a measure of waste and corruption which would be intolerable under taxes not levied in this burdenless way. The same is true, only to a less degree, of our other great cities, in which urban rents are also large and rising, and in which also taxes on sites are steadily productive of increasing revenue.

§ 4. Whether a tax on real property be collected in the first instance from owner or occupier is, in the long run, not material. The practise in the United States is to levy on the owner; and in the preceding sections the incidence of taxes has been discussed as if this were always done. In England, and in European countries generally, however, the practise is to levy on the occupier.

If the occupier is called on to pay the tax or taxes on real property, both he and the owner will consider the payment in calculations as to rentals. So far as the tax is levied with respect to site value, the pecuniary advantage of the site to the tenant is diminished by the amount of the tax, and the rent he will pay in order to secure the site will be so much less. If, on the other hand, the tax levied with respect to buildings and improvements is collected, not from the owner, but from the occupier, the owner obviously will be able to offer the facilities at a lower rate, and will be impelled by competition so to offer them. The nominal rental in either case will be less if

the occupier is called on for the taxes. The difference is in the mode of collection, not in the incidence of the tax.

All this holds good, however, only if taxes are certain in amount, and thus calculable. Unexpected taxes are likely in all cases to remain once for all a burden on the persons from whom payment is directly demanded. If owner and tenant come to an agreement as to rentals, a new tax or an increase of tax falls, during the term of the agreement, on that one of them who is directly chargeable. In the United States, where the practise is to levy on the owner, it is he who feels the brunt of all new taxes or increased taxes. He can shift them to his tenant (if at all) only when the time comes for a new lease. In England, where the practise is to levy on the occupier, he in his turn must pay during the term of his lease, and can effect a readjustment in such manner as to leave the tax burden on the owner (in the case of site rental), only when the time for renewal comes. In the United States, it is not infrequently stipulated in leases that the tenant shall assume all taxes, even though the landlord be chargeable with them by the law. Clearly, both owner and tenant will consider this assumption of liability in their bargain as to the stipulated rental. Such an agreement concerning tax payment is often simply a way of chaffering about the rental, especially where site rent plays a large part. If the site be valuable and in demand, the tenant will assume the payment of taxes virtually as a mode of bidding higher for the site, and will take his chances as to unexpected changes in tax rates.

Another difference between American and European practise is in the basis of assessment. In the United States taxes on real property are commonly assessed on capital value, that is, on selling value. In Europe they are usually assessed on annual rental value. Thus in the United States the usual tax on real property is some such rate as \$1.50 per \$100 of selling price, or 1½ per cent on the capital, charged on the owner. In England a common tax rate is 5 shillings in the pound of rental value, or 25 per cent of the rental, charged on the occupier. These

rates are roughly the same in their proportion to rentals. And in either case their incidence is in the end the same, differing (in the manner described above) according as the realty owes its value predominantly to site or to improvements. There is, indeed, one case in which the two methods reach different results; namely, where rental value does not correspond with capital value. This is most striking where urban land is vacant, and yet has a selling value because of the rent which it would yield if occupied, or which it is expected soon to yield from the growth of population. Such land has, as it stands, no rental value, or an insignificant rental value, and in England it is taxed lightly or not at all. Because it has a considerable selling value, it may be taxed heavily in the United States. The case is similar where the land, though built on and used, is not used to best advantage, having obsolete or temporary buildings. It would then be taxed lightly in England, on the basis of its actual rental. It would be taxed heavily in the United States, on a selling value representing the capitalization of its potential rent.

The American practise has advantages and disadvantages. It has the advantage of forcing land into use. Every owner, being taxed on the capital value of his land, is under pressure to make its contract rental correspond to its potential rent, and hence to improve it rapidly. The English practise permits the owner to wait. He will often wait, partly from inertia, partly from a wish to bide his time until the most profitable use of the site becomes quite clear. The American practise has the disadvantage of stimulating a feverish haste in getting sites into use. The general speculative and profit-gathering trend of American life would doubtless lead in any event to some such haste; but it is made greater by our method of taxation. Hence the sprawling aspect of those American cities which are rapidly growing. Lots in outlying districts are built on, perhaps prematurely, with the design of getting a return from rentals; intermediate lots are vacant, their owners holding on for a while. In England, where rental value alone is the basis of

taxation, land comes into the market in a more slow and orderly fashion. The American practise, on the other hand, has the further advantage of appropriating for the community, through the machinery of taxation, a larger slice of the unearned increment.

§ 5. Workingmen, like all occupiers of dwellings, are reached by the taxes on dwellings. They are indeed reached also by the taxes on shops and factories, which enter into the expenses of merchants and manufacturers, and tend with more or less irregularity to be shifted to consumers. But this second sort of shifting is so concealed as to be difficult to follow in any concrete way. Taxes on dwellings, however, so far as they are levied with respect to the structures, increase house rentals unmistakeably, and so cause their occupiers, and the workmen among them, to bear a share of the public burdens.

This indirect and concealed effect of taxation on workingmen appears not only in the United States, where all such taxes are first collected from the owners, but in England, even though they are usually collected from the occupiers. The English mode of levy is subject to exception in the case of workingmen's tenements. Here the taxes are collected not from the occupier, but from the owner; or, if not from the owner of the site, from a lessee who has taken the whole of the premises and sublets them to the actual occupiers. The same obstacles which stand in the way of the collection of income taxes from persons of small means appear where taxes on real property are sought to be collected from the occupiers of small tenements. The expense of administration is larger, and there is irritation to the taxpayer. It is much simpler to charge the landlord a lump-sum tax on the whole, and let him recoup himself by larger rentals from the several tenants or subtenants. This is commonly done in London and other large English cities, the landlord being allowed to "compound," as the phrase goes, and getting a slight reduction from the usual tax rate by way of commission for thus acting as taxgatherer.

The final result is that the workingman is taxed, but rarely

knows that he is taxed. He pays the going rentals for his house room, and does not know that in this rental is included a tax charge. The situation is doubtless inevitable; but it is unfortunate. It much affects the attitude of the average laborer toward public affairs. All that he is conscious of is the public outgo, which he knows about because the city or state is an employer of labor. The public income from taxes does not seem to concern him. He is commonly in favor of expenditure, with little regard to the wisdom of the expenditure; for increased taxes seem to be none of his concern. Some sort of direct levy on every voter would much promote watchfulness and discrimination in public affairs; yet it seems hopeless to retain any taxes of the sort.

§ 6. Taxes on real property are in the United States and in Great Britain chiefly local taxes. That is, they are levied and collected chiefly by the local bodies, — by the towns, cities, and counties in the United States, by the boroughs and counties in England. The revenue from them then goes to defraying the expenses of the local bodies. Yet this limitation to local use is by no means universally or completely the case. A land tax levied by Parliament still exists in England, though it has come to be small in amount, and is in process of extinction. The English income tax reaches income from real property, and the revenue so obtained goes to the central government. In the United States the revenue of the several states was originally derived, and is still largely derived, from the general property tax (to be presently considered) in which the taxes on real property have been by far the most important constituent. Nevertheless, it may be said that in English-speaking communities the tendency is toward using taxes on real property as strictly local taxes, leaving the central government to get its revenue in other ways, — by income taxes, inheritance taxes, taxes on trade and communication, not least, taxes on commodities.

The same tendency is beginning to show itself on the Continent. There taxes on land and buildings, through long use and

continued tradition, have been assessed and levied by the central government. The local bodies, the communes, have simply followed in the track of the central government, using its machinery and its assessments, and imposing for their own purposes supplements or percentual additions to the state taxes. Such is still the situation in most countries of the Continent. But a break in the system has been made in Prussia, where taxes on land and buildings, and some other so-called "direct" taxes of a similar sort, have been turned over once for all to the local bodies, the state retaining for itself the income tax. Other German states have followed the Prussian example, and it is probable that in the course of time other countries of the Continent will do likewise.

This relegation of taxes on real property to local bodies is wise. Local bodies are most likely to administer such taxes equably, and in administering them are free from difficulties which commonly arise in local administration of other levies. Income taxes, for example, tend to drive people away from the places where they are imposed; if local, they would induce a competition between cities and towns to attract residents by low rates or lax assessment. Taxes on securities are open to the same objection, as will appear more clearly in the next chapter. Most taxes on the production or sale of commodities are subject to similar competitive evasion. The list of taxes really available for local bodies is limited, while at the same time their financial needs are great and growing. Hence it is desirable that taxes on land and buildings, which are peculiarly available for local bodies, should be left to them solely.

CHAPTER 69

The General Property Tax

§ 1. The familiar system of ~~local~~ taxation in the United States is that of the general property tax. Taxes ~~on~~ land and buildings, the effects of which were considered in the preceding chapter, are in this country simply parts of the general tax on all property. That tax, in its earliest stage and in its simplest form, was the sole direct tax, and was a universal tax. That is, it was levied on every person in proportion to all of his property. Such a system commends itself to most people as *prima facie* just. Let the rich pay in proportion to their riches, others in proportion as they are more or less rich: what can be more equitable?

Where the ownership of property is widely diffused, and where property is used by the different owners in substantially the same ways, the result, in fact, sufficiently conforms to equity,—assuming, of course, that taxation is equitable when simply proportional. In the early stages of the industrial development of our colonies and states, conditions of this sort probably existed, and the general property tax doubtless was satisfactory in its operation. Then almost every one in the community held landed property, and his income was roughly in proportion to his property. Professional men were few; and they were usually owners of houses and land, and taxed on these. Merchants had visible stocks of goods, and they also as a rule owned real estate in addition. Shipowners (in New England, say) had visible property, and usually land. All were reached by taxation on property, and were reached in rough but sufficient proportion to their income. The same seems to be true at the present time in those Southern and Western states which

are still predominantly agricultural. There nearly every one from whom taxes can be collected at all owns land, and is prosperous or not in proportion to his ownership of land or of other tangible property.

Under such conditions a general tax on property is not only approximately equitable, — and in all tax systems an approximation to equity is all that can be hoped for, — but is the system easiest of administration. Strictly speaking, of course, there is no such thing as a tax on property. Taxes which we speak of as taxes on property are levied on individuals with respect to their property or in proportion to their holdings of property. The taxes come not out of the property, but out of the incomes of the property owners. These incomes may indeed be derived from the property or in connection with its use; but they may quite conceivably be derived in other ways. Yet, while all taxes must come normally out of income, the actual ascertainment of income may be, and often is, more difficult than that of property. In a farming or planting community, few people could reckon up their annual incomes with accuracy. Part of the income is in kind, part of it is derived from sales which are subject to deduction for various expenses. To tax in such a community on a basis of income would lead to endless confusion and evasion. To tax on the basis of property is simple, and comes to very much the same result in the end as would be reached by a rigorous tax on incomes.

§ 2. In a complex community of modern times, however, such as all European countries have come to be, and as most of our own states have come to be, the general property tax proves hopelessly impracticable. It leads to glaring inconsistencies and inequities, and fails completely of attaining its professed object.

The first and most obvious difficulty arises from the circumstance that, as the community ceases to be simple and homogeneous, property and income no longer run side by side. All sorts of income develop which do not rest on the ownership of

property. Such are the incomes of lawyers, physicians, and other professional men, of salaried officials, of prosperous mechanics, of propertyless laborers. The last-mentioned classes — mechanics and laborers — are not commonly supposed to present problems in a tax system based on property levy; because it is tacitly or openly assumed that no taxes at all should be laid on them. It has already been said that this is not a reasonable view, and that the failure to levy on them directly is to be explained by the administrative difficulty of reaching them rather than justified on any sound principle. But in any case there are plenty of prosperous income earners whom all would admit to be justly taxable, and who would be reached not at all by a simple property tax. These are persons having "unfunded" incomes; which, though perhaps not thought justly taxable at the same rate as funded incomes, surely would not be thought by any one to be entitled to complete exemption from taxation. The incomes of business men, so far as they are business profits in the strict sense, belong in the same class, and have but a loose relation to the property holdings of the several individuals.

Further, difficulties of administration arise at an early stage in industrial growth. The difficulty mentioned in the preceding paragraph would exist, even if the tax were carried out in full accord with its theory; but it soon proves virtually impossible so to carry it out. Not all the property supposed to be reached can, in fact, be reached. Land and buildings, machinery, farm animals, and the like bulky forms of property cannot be concealed. They are unfailingly assessed and fully valued by the tax officials. But other forms of property can be concealed, or at least are not susceptible of easy and accurate assessment. Such are the stocks in trade of merchants and dealers, and goods in process of manufacture. As to these, a declaration of amount and value must be sought from the taxpayer. This at once opens the door to understatement and evasion; the more so, because it brings an unwelcome intrusion into what are supposed to be private affairs. The temptation to evasion, of

course, becomes stronger as the tax becomes heavier. A modest rate of $\frac{1}{4}$ or $\frac{1}{2}$ of one per cent on the capital value, such as was common in the American states a century ago, causes comparatively little trouble. But when the rate rises to one, two, even three per cent, as it has done during the last half century, all the most hateful phenomena of taxation appear, — lying and equivocation by the taxpayers, alternate harshness and laxness by the officials.

Most striking among the perplexities and difficulties are those which appear as lending and borrowing and purchases on credit develop. To tax a man on his property without making allowance for his indebtedness is manifestly not in accord with the general intent of a property tax. Yet to allow for indebtedness opens the door to easy evasion. In Massachusetts at the present time, a merchant having a large stock of goods on hand is taxable on the full amount, no deduction being permitted, even though his debts should be as great as what is nominally his property. This stern rule, however unjust in principle, finds at least an excuse in the experience of New York, where the contrary practise prevails: indebtedness is allowed to reduce the tax assessment. In New York any one who is dissatisfied with the tax collectors' demand on him not only declares his real debts, but cooks up a debt if necessary; perhaps swears to one that does not exist, or salves his conscience (men do such things) by getting a friend to become *pro forma* a creditor. The process of "swearing off" the assessments of personal property is carried so far in New York as to make this part of the tax system a farce.

Still another and even more troublesome consequence of the interlocking of property rights and the development of indebtedness is the difficulty of reaching the creditor himself. The property of many persons, and especially of well-to-do persons consists largely of claims against others. They have debts due to them, evidenced commonly by promissory notes, bonds, public securities. These papers are property in the eye of the law, and are taxable as such. But they are the form of prop-

erty most easily concealed. The difficulties encountered in reaching stock in trade and the like personal property are encountered in vastly greater degree in regard to this most intangible element. And here, again, the difficulty becomes greater in proportion as the tax rate is high. There never has been in our American states anything more than a pretense of bringing the actual taxation of this sort of property into conformity with the letter of the law. Usually there has been not even a pretense. The property tax, while nominally applicable to all property, has been applied in fact only to real estate and those forms of personal property, such as expensive plant and machinery in the cities, or farm animals in the country, which are as easy to see and to value as land and buildings. Other forms of property, and especially notes, credits, and the like, are not taxed at all, or taxed by the merest guesswork.

The final cause which has led to the breakdown of the property tax has been the extraordinary development of corporations, and so of the ownership of wealth under corporate form. Stocks, bonds, and corporate securities of all sorts are the form in which riches are likely to be held. All these are property, and taxable as such; though taxable, as we shall see, in different ways as the legislation for the property tax has tried to adapt itself to this situation. However taxable in the eye of the law, they are rarely taxed to the holder in fact. Evasion is the rule, not the exception.

§ 3. The full breakdown of this mode of taxation in the United States, in face of the complexities of property ownership in the modern world, has come, as already intimated, with the increase in the rate of taxation. That rate has come to be usually from 1½ to 2 per cent on the value. Securities and the like investments yield ordinarily something like 4 or 5 per cent on the capital value. The property tax, if collected as the law contemplates, would therefore be equivalent to a tax of from 30 or 50 per cent, even more, on the income. It is extraordinary how people allow themselves to be deceived on this subject by names. Persons who denounce an income tax as inquisitorial

and confiscatory and "un-American," none the less, because they find the existing method labeled a "property" tax, accept it as part of the normal order, and oppose it with none of the fervor which the income tax proposal arouses. The property tax, if levied on securities, must be paid, like all taxes, from income. It amounts to a tax so high in relation to income that it may be called really confiscatory. No government has ever attempted to collect an income tax so heavy, least of all has attempted to collect it with an administrative system as bad as that of our American cities and states.

So far as securities are concerned, evasion of the general property tax is so general that it is rarely reckoned with in adjusting investments. A familiar mode of evasion is by change of domicile to a place where no pretense is made of enforcing the tax as regards "intangible" property. Under the law, the "situs" of personal property is at the owner's domicile, and at that place the property is taxable. When the tax rate becomes high in a city and is sought to be collected on securities, — and of course it is in cities that the owners of such property are likely to live, — it is often easy to shift residence to a suburb where the authorities are more complaisant. The suburb has everything to gain and nothing to lose by the transfer. If a person of means settles in it, his dwelling becomes taxable there and adds so much to the town's resources, without adding appreciably to its expenses. If the town be otherwise attractive, it will readily become a "residential" suburb, and more or less of a tax-dodger's paradise. Attempts to enforce the normal tax law to the letter have commonly resulted in the growth of such tax-dodging resorts. Of course, it would be possible to check this particular tendency within any one state by making the rate of taxation (on securities and the like) uniform throughout the state, and by providing for rigid and uniform assessment by state officials. Even so, there would remain the possibility of change of domicile from the severe state to a neighboring lax state, — a possibility which would become a probability in the case of the very rich, who are not tied to any one place

of residence. Uniform action by all the states in such a matter, it would be hopeless to expect. Notwithstanding all the dissatisfaction with the system as it has come to work, and notwithstanding occasional efforts to make it work in accord with its theory, no American state has resorted, even singly, to uniform and centralized assessment and collection.[1] Consequently, the option of a change of residence has always been open to the threatened taxpayer; and the mere existence of this option has served to temper the activity of would-be energetic or conscientious tax officials.

None the less, spasmodic and irregular attempts to enforce the law are made from time to time. Property which happens to come under the very nose of the tax assessor, and which he cannot overlook, becomes subject to taxation. Thus, securities belonging to estates which are in charge of the probate courts during the process of transmission to heirs and legatees, may get into the net; for here there is necessarily some publicity. For a brief space the full tax may be collected on such property, very likely from persons least able to suffer the loss of income. After a while, they rearrange their affairs, and in some way conceal or evade; unless, indeed, they belong to that very small class of highly conscientious persons, to whom any act of indirection is impossible. Equable and uniform application of the tax never has been made. In its practical operation, as regards what is called "intangible" property, it is haphazard, ineffective, productive of small revenues to the public, and demoralizing alike to taxpayers and tax officials.

As matters stand in the United States, the traditional tax system works best where the letter of the law is disregarded and the property tax is in fact applied only to land, buildings, and other things bulky and visible. This is far from being a satisfactory situation. It means that the law as it stands on the statute books is disregarded. It means that no pretense is

[1] Since the first edition of this book was issued, Wisconsin has adopted a system of centralized administration for her state income tax, referred to below; and a similar movement is going on elsewhere.

made to carry out the ideal of justice which underlies the law. Not even that rude proportionality which would result from taxing on the full property basis is striven for in actual administration. The ultimate incidence of the system in this phase of its actual working is difficult to follow; but there is no ground for supposing that it brings results in accord with any principle of proportional taxation, still less of progressive taxation. Yet, when confined to realty, and to personalty that is like realty, it is at least simple and calculable. People adjust their affairs to it, and there is not the uncertainty and demoralization which come from the endeavor to carry out an impossible system.

It is because of the process of adjustment that the property tax, when confined chiefly to real property, ceases to be a subject for complaint and recrimination. It becomes in large degree a shifted tax. So far as it is on sites, it remains, to be sure, on the owners; but as these are probably purchasers of comparatively recent date, or have been holders for so long a time that capital value has been adjusted on the basis of a tax deducted from the income, they are hardly conscious of a burden from the levy. The taxes on buildings tend to be shifted to occupiers; and those on buildings used for business tend to be further shifted, through the occupiers, on the community at large. There are, indeed, some persons as to whom it is tolerably certain that they will feel a real and continuing burden of the tax on their own shoulders. Such are those who own and occupy their dwellings. The same is substantially the case of the farm owners. On his dwelling the farmer pays the tax once for all, like any other house owner. On the improvements to his farm he is, abstractly considered, in the same position as any other improver of land, — the tax may be shifted. On moderate agricultural properties, however, held and tilled by their owners not only as business capital, but as homes, the process of shifting takes place with great slowness and uncertainty. On the other hand, it takes place with comparative certainty for the great mass of buildings and other

improvements on land, which are made simply and directly for investment, whether for use in production or for rental as dwellings. How difficult it becomes, then, to say whether the final outcome is in accord with any principle of justice in taxation! And even so, the last word as to the incidence of this mode of taxation has not been said; for, as will appear presently, there is in the background a further possibility of ulterior effects.

§ 4. The position of corporations and corporate securities in the general property tax calls for some further consideration.

The shares of a corporation in the hands of its members are property, and as such, under strict legal interpretation, would be taxable to their owners. But it would be obviously absurd, where corporation and shareholder live in the same jurisdiction, to tax the corporation on its property and also the shareholders on their shares. Hence, it is usual not to tax the shareholders as such; the corporation is taxed, and the shares in the owners' hands are exempted. This simple and reasonable mode of treatment has usually been the result, not of explicit legislation, but of construction of the statutes by the courts, which have assumed it to be the intent of the legislature to tax the property once, and not twice under different names.

This mode of treatment, however, is not commonly adopted where the corporation is in one jurisdiction and the shareholder lives in another. Suppose the corporation is one which carries on all its operations in New York, — say a manufacturing corporation having all its property in that state. A shareholder lives in Massachusetts. Shall he be taxed in Massachusetts on his shares in the New York corporation? The common practise is to regard these "foreign" shares as property, and to tax them once for all. It is not the universal practise. In the state of New York itself, in the converse case, that of a New Yorker holding shares in a Massachusetts corporation, the courts have held (construing a statute whose language is not explicit) that foreign shares are no more than evidences of

property existing elsewhere, and that they do not constitute property "situated" within New York; therefore they are not to be taxed in New York. In some other states the same outcome has resulted from similar judicial decisions. But as a rule such shares are regarded as property whose "situs" is within the state where the owner lives, and they are taxable, in theory of law, precisely like real estate or any other sort of property.

The result is "double taxation." That is, the property itself is taxed in one place, and the paper evidence of its ownership is taxed in another. To tax twice the same property (or, to speak more carefully, the income from the same property) is not necessarily objectionable. In England, and in other countries having an income tax, there are taxes levied directly with respect to real property, and, in addition, taxes on the income from that property. But since all property and all persons are treated alike in this regard, the duplication gives no ground for complaint by any individual. It simply serves, in most cases, to demarcate levies for different purposes, — the taxes on property being more commonly for local purposes, those on income more commonly for the needs of the central authority. A real ground for objecting to double taxation exists when some individuals are taxed doubly, and others are not. This occurs when those shareholders are taxed who live in a different jurisdiction from that of the corporation, while those living in the same jurisdiction are not taxed.

The same problem presents itself as to the other important class of corporate securities, — the bond or debenture. But in this case the difficulty is simply ignored in most of our states. Bonds are usually taxed without question. In the eye of the law, a bond is a debt like any other, and is not, like a stock certificate, an evidence of ownership; and it is "property" in the hands of its owner. In the eye of the economist, however, a bond is essentially similar to a stock certificate. It is paper evidence of the presumable investment of capital and the presumable existence of corporeal property. Whether the claim

on corporate property shall take the one form or the other, depends on all sorts of considerations, — the state of the law, the habits and prejudices of investors, the nature of the various enterprises. The stocks and bonds of a corporation, taken together, represent the effective ownership of its entire property. To tax all the property of a corporation, and then to tax the bonds also, is to all intents double taxation as much as it is to tax the shares in the same way. Yet it is common not only to tax the bonds when they are held by persons in other states, but when they are held by citizens of the same state. That is, the bonds are taxable under the letter of the law In fact, their holders are rarely subjected to taxation, just as the holders of shares are rarely taxed. The breakdown of the general property tax is equally conspicuous as to all the classes of corporate securities.

The remedy for this demoralizing situation is in principle comparatively simple: tax the corporation and disregard the securities and the security holder. Apply the device of taxation at the source. Or, at least, disregard the security holder so far as the tax on property is concerned. This would not be difficult if the United States were one jurisdiction, or could be treated as one jurisdiction. And it is not in fact difficult where corporation and security owners are in the same state, as is often the case with locally owned corporations of moderate size. But for the great corporations which have become so characteristic and widespread in our time, the problem of interstate apportionment of taxes is often very intricate. It is not within the scope of this book to consider the details of this important problem, complicated as it is not only by economic difficulties and by existing adjustments and vested anomalies, but by legal and constitutional intricacies. The legislation of the several states is slowly working in the right direction as regards the corporations themselves, — toward taxing them fully, and taxing them (on the whole) with reasonable regard to the proper apportionment of taxes between the different states in which they may conduct their operations. The frequent opposition

of the corporations themselves to equable taxation — to taxation that is on the same basis and to the same extent as other property holders — is among the serious obstacles to reform. Such opposition is as natural and inevitable as that of any set of persons from whom taxes are demanded; but in this case it adds to the complications by intensifying the popular repugnance to exempting the security holders. That exemption is the logical corollary of the complete and effective taxation of the corporations themselves. Yet, except as regards the shares of so-called "domestic" corporations, that is, corporations which are within the same jurisdiction as the shareholders themselves, there is little observable tendency toward this further step. We still find, commonly, draconian severity in the letter of the law and almost cynical laxness in its administration.

Even if the principle stated in the preceding paragraph were consistently carried out, all difficulties as to the taxation of corporations and corporate securities could not be said to be removed. There would remain unsolved at least one problem of peculiar importance in the United States: the apportionment of taxes between different jurisdictions, when the income is derived in the one and enjoyed in the other. A man lives in Massachusetts, and has income from property in New York: by which shall he be taxed? perhaps by both? It is natural, nay, in accord with the principles of equity, that the state in which he lives should call on him to contribute to its public burdens; and equally natural and equitable that he should be called on by the state in which is his income-yielding property. Under existing American legislation and practise, it is settled that where real property is owned in one state, and the owner lives in another, he is taxable, as to property of this kind, not where he lives but where the realty is. But where there is a paper evidence of ownership, the state of residence is usually glad to seize on the strict legal interpretation of the word "property" and tax its resident on his stocks or bonds or mortgages, even though these be but claims on property existing

elsewhere. I know of no clear ground of principle on which to settle the just apportionment of taxes in such cases. The taxpayer may protest with reason against being called on twice; yet each state may maintain with justice that it should receive taxes from him. Where there is, or purports to be, but one single mode of taxation (as is the scheme of the general property tax) the simplest solution would seem to be that of Solomon, — cut the object of contention in two, and let each claimant take half.

§ 5. Notes secured by mortgage are, as regards the problems of taxation, analogous to corporate securities. They stand for a claim against property, for a sort of ownership; they are evidences of partial ownership, not property in themselves. Where the mortgaged property and the mortgage note are within the same jurisdiction, the solution, or at least the first step toward solution, is again comparatively simple. It is absurd to tax as "property" both items *in toto;* though this is the attempt made by the law in many of our states. The sound rule, obviously, is not to tax both creditor and debtor, but to subject the whole property to one tax only. And this presents no very serious difficulties where both parties live in the same jurisdiction. Just in what manner the apportionment of the one tax is best arranged between the two parties is not always easy to say. One method is to tax the creditor (the holder of the mortgage note) on the full value of his claim, and the debtor on that value only of the property which is over and above the amount of the mortgage. It is entirely possible to reach the creditor with certainty, if within the jurisdiction; since, for the full security of the claim, all mortgages must be recorded. In this case, however, there is reason to expect that the lender, having the certainty of the tax before him, will reckon on it in his bargain with the borrower, and will raise the stipulated rate of interest in such way that the borrower really pays the tax after all. The other method is to exempt the creditor's note from taxation as property, and to tax the whole property once for all in the hands of its titular

owner, mortgaged though it be; trusting to the effect of competition among the tax-exempt lenders to bring the rate of interest down to the minimum, and so give the borrower terms as easy as he could get under any circumstances. This second method is most in accord with a consistent application of the general property tax, and is easiest to administer; but it is not certain from experience that the mortgage borrower will always get the benefit of competition and of a lowered rate of interest as fully as is expected.

When, however, there are conflicting jurisdictions, the problem as to mortgages becomes more troublesome, as it does in the case of corporate securities. Suppose the mortgaged property is in one state, while the creditor who holds the mortgage lives in another. Shall both be taxed on the full value of their "property"? Here, as in the other case, there seems no certain principle for settling the just apportionment of taxable liability between the two jurisdictions; none, at least, so long as property, not income, is the basis on which taxation is supposed to rest. The practise of our states is indeed perfectly clear, or, rather, the letter of the law is clear. It simply ignores the difficulty. All mortgaged property is taxable to the full, and it is taxed to the full. Claims by mortgage creditors in other states are quite ignored. And, similarly, the mortgage notes themselves, when they are a lien on property not in the same but in another state, are taxable in full where the creditor lives. These are taxable, be it noted; which is very far from saying that they are taxed. Commonly they are not reached by the tax collector, just as corporate securities are not reached.

All problems of this sort are much simplified where there is not one single form of taxation, — as the general property tax originally was, and in many states still is, — but a diversified tax system, reaching different objects of taxation in different ways. Suppose, for example, that in addition to taxes on property — either on real property alone, or on other forms of property also — there are taxes on income. It may then be reasonably laid down that the taxes on property shall be paid

where the property is, while those on income shall be paid where the owner is. Thus in Great Britain, local taxes ("rates") are levied on all real property; in addition, the owner is charged with an income tax on his income from the real property. If, now, a British subject owns real property in the United States, or shares in American corporations, he is taxed in Great Britain only on the income received in that country from the foreign property. If our states had not only the familiar property tax, but other taxes as well, a similar division would be much facilitated. Inheritance taxes, for example, such as our states are freely adopting, might reasonably follow the owner, and be levied solely at the place of his residence; although, unfortunately, as regards this form of tax, the practise of different states (both American and foreign) is by no means uniform. The proper place for levy is not in this case so obviously settled by the fact of residence as it is in case of income taxes. None the less, the satisfactory solution of the problems arising from conflicting jurisdictions, and indeed of many others in public finance, is made much easier if there be not one tax, but several taxes, serving not only to reach different kinds of persons and incomes, but available for apportionment among the several jurisdictions.

§ 6. Another large and important class of "intangible" personal property consists of public securities, issued by states or by local governments.

On such securities, though no material property exists to which anything analogous to stoppage at the source could be applied, the method is none the less possible of application with the most absolute ease and certainty. An income tax can be collected from the holders of public securities in this simplest of ways. A tax on their capital value could conceivably be collected on the same principle, — the state deducting the tax before paying the stipulated interest. Yet it would obviously be fatuous for any public body to undertake anything of the kind, at the rates usually levied on property under our American system. No state or municipality which thus taxed its

securities, at one or two or three per cent on their capital value, could think of marketing its securities. Yet, nominally at least, our states tax the securities, in the hands of the holders, at just such rates. In fact, they are hardly ever taxed; it would seem hardly to need repeated experience to show the hopelessness of so reaching them. Yet the pretense of taxing them usually remains on the statute books,—a curious illustration of the willingness of democratic communities to accept legislative shams.

So complete and obvious is the sham, that, in recognition of it, public securities not infrequently are exempted from taxation once for all. The federal government, in order to make its bonds attractive to investors, has long enacted that they shall be tax free. Our American states and cities are tending to follow the example, each public body calculating that it will gain more from some slight lowering of the rate of interest than it can possibly derive from direct taxation of the bondholders. Though the securities, when taxable, are usually concealed and rarely reached, the fact that in the eye of the law they are not free, and the possibility that a tax may be unexpectedly levied, has an effect on the rate of interest at which investors will take them. Tax-exempt bonds can be marketed at a rate of interest from ½ to ¼ of one per cent lower than on taxable bonds. The gain to the borrowing state or city is not great, but it is still something.

Yet this exemption, though better than the futile pretense of taxing the securities on the usual plan of the American property tax, is not to be commended under a more rational system. Something might indeed be said for it, under a careful system of taxing all funded incomes or income-yielding property, if taxes of this kind (whether levied with respect to income or to property) were always at a uniform rate. If, for example, there were a general tax, really enforced, of ten per cent on all incomes, and if the tax were to remain permanently at this rate, — it would be indifferent to the borrowing state or city whether it secured this deduction from the stipulated interest

in the form of a tax, or negotiated its loans at a rate of interest diminished ten per cent because of tax exemption. But this identity in the outcome would be secured only if the tax were certain to be always the same, and if other investments were subjected to it without fail. The second of these conditions is difficult enough of realization. The first — steady uniformity in the tax rate — is not desirable, and hardly possible. No community can commit itself indefinitely to uniformity in its tax operations. Financial needs must vary; unexpected exigencies are sure to arise; changes and rearrangements in taxation are inevitable. To stipulate once for all that any one form of property or income shall be released indefinitely, or for a very long time, from taxation, shuts the door to the future, and can be justified only by extreme financial stress. Hence such a practise as that of the British income tax act is preferable. There the income tax is deducted from the stipulated interest payable to the owner of consols and the like government securities; the rate of the tax varying from year to year, and the owner being subject, like any other investor, to a variable deduction from his income.

§ 7. How to deal with the holders of the various kinds of securities is in all countries the most troublesome problem in taxation. Where there is a tangled and unsatisfactory situation, the temptation is strong to make out a program for reform. As regards some essentials, such a program is easily prepared for our American tax situation. But on important aspects of the problem no policy can be urged as definitive.

The first thing on which all intelligent and well-informed observers are agreed is that the system of general property taxation should be given up, or at the least should be broken up into parts. In some of our states, unfortunately, there are obstacles in the way of this preliminary change because of clauses in their constitutions, more or less explicit, requiring that all taxes shall be uniform on property. Like other clauses inherited from older days when industrial conditions were different and traditions of social justice were different, these have proved to

interpose unexpected and unwelcome obstacles to needed reforms. More freedom and discretion than they allow should be given to the legislatures. Least of all should there be a constitutional requirement of a uniform tax rate on all the complex forms which property takes in modern times.

Given discretion, the question arises in what way it shall be exercised. Various methods have been suggested and are on trial in one state or another.

A simple plan is that of exempting securities and their income once for all. In favor of so proceeding it may be urged that the task of taxing them directly must be given up as hopelessly impracticable; and, further, that this sort of income is sufficiently reached through the taxation of corporations and of inheritances and through the federal income tax. The legislation of the state of New York proceeded in this direction, — though not so much by any deliberate policy as by a series of isolated steps, — until a close approach to complete exemption was reached. Yet this outcome is not satisfactory, either on grounds of principle or of political expediency. It makes no attempt to get from the security holders a clearly defined contribution representing their share of the public burdens of the locality in which they reside. It is open to the strong political objection of being repugnant to the plain man's sense of justice; it has the appearance, even though it may not bring the reality, of completely releasing from taxation the rich and well-to-do.

Another method is to tax securities, for state or local purposes, or both, at a moderate fixed rate on their capital value. Pennsylvania, for example, long had a tax on most securities of 4 per 1000; which, assuming the rate of return on the securities to be 4 per cent (40 per 1000), would be equivalent to a levy of 10 per cent on the income. A tax of this kind — 3, 4, or 5 per 1000 of capital, *i.e.* from 5 to 10 per cent on income — has been proposed in other states, and is on trial in some. It has the advantage of fitting readily into accepted ways and habits. Tax assessors and the people generally are accustomed to taxes based on the capital value of property. It has the obvious

disadvantage of not being in any certain proportion to the income enjoyed; indeed, like the general property tax itself, it continues to be levied even though there be no income at all.

Last may be mentioned what seems the simplest measure of all, and indeed in principle is the simplest and most obvious: a tax not on the selling value or principal of securities, but on their income. This might naturally be arranged as part of a general state tax on incomes, or at least on those incomes which cannot be reached through levies on visible and tangible property, — derived from the professions, from business, salaries, royalties, as well as from securities. The troublesome problem of apportioning taxes on corporate property between different jurisdictions is solved thereby in a way that is consistent and logically defensible, and at the same time is easy of explanation and justification. Tax the property where it exists, tax the income where it is enjoyed. One leading state set an example in 1911: Wisconsin proceeded to a state income tax. The Wisconsin tax was administered, not by the local bodies (cities and towns), but by a state tax commission; a body which was charged also with considerable powers of control over other parts of the state's fiscal system.[1] Some such centralization — perhaps better described as coöperation between local and central authorities — is indispensable to the satisfactory working of any legislation that aims to reach personal incomes and incomes from movable or intangible property. It remains to be seen whether other states will follow the example thus set and whether there will be found in this direction a satisfactory solution of the perplexing problem.

Whatever plan of legislation is adopted, administration at the hands of capable officials, independent of political vicissitudes, is essential, — a requirement which, it cannot be too often said, is fundamental for every one of our needed social and economic reforms. This met, it is by no means impossible to devise a tax system, perhaps on the plan of an income tax, that shall be sufficiently reasonable and therefore enforcible.

[1] The Wisconsin system is described by T. S. Adams in the American Economic Review, December 1911, and in the Political Science Quarterly, December 1913.

§ 8. One important and difficult question of principle remains to be considered. More than once, in the preceding sections, it was pointed out that a tax on any one kind of investment, if unfailingly collected, is likely to be in some way shifted. A tax on buildings is likely to be shifted, for example, to the occupiers, if the owner is deprived by it of the ordinary return on investments. A tax on mortgages is likely to be shifted, in the form of a higher rate of interest, on the borrower. But all this assumes that the owner of the building and the mortgage lender have an avenue of escape, — that other investments are available for them which yield the current return. Commonly enough, in the actual working of our American system, alternative investments are in fact available. There are tax-free securities in the way of corporate shares on which the corporation has paid the taxes; there are tax-free public securities; there are securities as to which, though they are taxable, the chance of actual taxation is negligible. But suppose that all these alternatives were treated in precisely the same way, or at least with precisely the same effect, by taxation. Suppose that, in whatever direction the investor turned, he were confronted by a tax, and a tax at the same rate, on land, on buildings, on mortgages, on corporate property or securities, on public securities. Could the tax be shifted in that case?

A similar question was much discussed by the economists of a century ago, as to the outcome of a general tax on wages. It was reasoned that such a tax would be shifted. The laborers, it was thought, got as wages no more than the minimum for support. Laborers simply *could* not be taxed. Taxes levied on them would necessarily cause a rise in wages, and so would come out of the employers; that is, out of the profits of capitalists. The same results were expected to follow from taxes on the necessaries consumed by the laborers. If wages were at the minimum, no margin would exist, and wages would have to rise enough to balance the increased price of the necessaries; otherwise, the laborers would die off. Hence, taxes on necessaries also came out of profits.

It is not worth while to follow this sort of reasoning, which engaged much of the thought of the older economists, in all its intricacies. Taxes levied directly on wages or on wage earners do not exist, and hardly ever have existed; they are too difficult and expensive of collection. Taxes on food and other things consumed by laborers, whether necessaries or comforts, are common enough; but, fortunately, wages are not so close to the minimum, in civilized countries, that laborers are once for all unable to support such taxes. They do pay them, though as a rule they are but dimly aware of it. The reasoning about the reactions that might follow from taxes on wages is worth attention, chiefly because it raises the question whether in all levies of this kind, whether on wages or on interest, the tax collector is not confronted somewhere by a minimum beyond which he cannot reach.

That precise question is raised by the supposition just made as to an all-embracing tax on property. Such a tax is equivalent to an all-embracing tax on the incomes from property, or from all funded incomes. Is there a minimum rate for such incomes? in other words, is there a minimum rate of interest? Suppose that a rate of taxation, such as is supposed to be levied under our familiar property tax, is, in fact, inexorably exacted. Suppose that rate to be two per cent, and the ordinary rate of return on safe investments to be four per cent. Then the net return remaining to all investors would be but two per cent. Would accumulation be maintained, and would the supply of capital continue undiminished? or would accumulation lessen, in such way as to diminish the supply of capital, and to raise the nominal return to six per cent, so that the net return, after paying the tax, would remain four per cent, as high as before?

Experience affords no answer to the question; for no country has ever tried all-embracing taxes of this kind and weight. The taxes which come nearest to being all-embracing, such as the income taxes of England or Prussia, have never been levied in civilized communities at any rates which really apply a

test. An income tax of ten per cent is very high in modern experience. But the effect of such a tax on accumulation is certainly negligible. Suppose, however, the tax were fifty per cent, rigorously exacted and universally applied: would accumulation be checked? We cannot answer with any certainty. As has been pointed out in the discussion of interest, we cannot be sure whether the rate of return now prevailing on investments represents the "productivity" of capital or the minimum price of accumulation, — its cost of production, so to speak.[1] Somewhere there is a limit, in the way of a minimum; and probably it is not far from the lowest rates — three per cent or two and a half per cent — which have been reached in some periods of recent history. The case is like that of taxing inheritances. At moderate rates, they do not check accumulation; at extremely heavy rates, they make the system of private accumulation and private property unworkable. It is impossible to say to the legislator, precisely so far shalt thou go, and no further; yet it is essential that he bear in mind the ultimate limitations, lest, in the excess of zeal, he go too far.

[1] Compare Book V, Chapter 39.

CHAPTER 70

TAXES ON COMMODITIES

§ 1. Taxes such as have been described in the preceding chapters, on income, property, inheritance, are commonly spoken of as direct taxes. By this phrase is meant that the legislator, in levying them, has no expectation or intention that they shall be shifted to any other persons than those first called on to pay them. Taxes which, on the other hand, are expected to be shifted to others are called indirect taxes. As we have seen, the so-called direct taxes are shifted not infrequently; but they are not levied with this in view, and the process of shifting is often uncertain. "Indirect" taxes, on the other hand, are levied on the supposition that the persons first called on will transfer the burden to others, and will transfer it with tolerable ease and certainty.[1]

The simplest and most familiar of indirect taxes are taxes on commodities. Here, again, it must be borne in mind that the phraseology is loose. Just as there are not, in strictness, any taxes on property, but only taxes which persons owning property are compelled to pay, so there are no taxes on commodities, but only taxes levied on persons when they deal with commodities in a particular way. A tax "on tobacco" may be, for example, a tax on the manufacturer of tobacco levied on the basis of the number of pounds of that article as they pass out of his factory. A tax "on sugar" may be, as it formerly was in Germany, a tax of so much per hundredweight of the beets used in making the sugar, collected from the manufacturer when the beets are delivered at his establishment. A tax "on imports" is one collected from merchants and others

[1] As was noted above (Chapter 67, § 7), the words "direct" and "indirect" are used in quite a different sense with reference to the limitations on federal taxes in the Constitution of the United States.

on the occasion of their bringing articles across the frontier from other countries.

The precise stage and the precise way in which these various persons are called on to pay such taxes is much affected by the possibility of evasion. Thus, under the method of taxing the beets formerly followed in Germany (now given up, for reasons that need not be here discussed), evasion was difficult, because beets were bulky, and the operation of bringing them to the factory could be easily supervised. The method used in our American taxes on tobacco, cigars, beer, spirits, of compelling the taxed person to buy stamps, and to affix these on the articles at a given stage in his operations, has the administrative advantage that the articles cannot be marketed, in case of evasion, on any except the smallest scale; since the absence of the stamps would inform all the world of the violation of law. Taxes levied on importation are collected with great ease in modern times, because the regular channels of transportation, by railway or steamer, are extremely cheap, and smuggling by out-of-the-way routes ordinarily entails greater expense than evasion of the duty would make worth while. In the eighteenth century the situation was different, and smuggling was a factor much to be reckoned with in the administration of import duties.

All these, however, are matters of detail, often very important detail, to be dealt with in special books on taxation and finance. Our concern is with some general questions as to the economic effects of taxes on commodities, — that phrase being used for brevity to describe the taxes levied in the various ways just indicated.

§ 2. Consider first the simplest case: an internal tax, or excise, imposed at some stage in the production of a commodity. A stage in manufacturing operations is in fact usually chosen, because manufacture means concentration of operations, and hence ease of supervision. Suppose the commodity to be one produced under the conditions of constant cost and of free competition. Then the effect of the tax is simple. In

the long run, the price of the commodity will be raised by the amount of the tax. The producer will shift this amount on the consumer, and the real burden will thus fall *in toto* on the latter.

This result will not be necessarily reached at once. The first effect of the tax is to add so much to the manufacturer's expenses of production. He will, of course, desire to raise his price so as to make good the additional expense. In strict theory, he cannot do so except in consequence of a decrease in supply. Price is determined directly by the equilibrium of demand and supply (or, in more technical language, by marginal utility), and it will not rise, the conditions of demand remaining the same, unless supply be lessened. But the higher expenses of production and diminished profits will tend to lessen supply; and normal equilibrium will be restored when the manufacturers are again getting their usual returns, with lessened output and higher price. Evidently the extent of the eventual change in the volume of output depends on the elasticity of the demand for the article. The result may even be reached, under some not improbable circumstances, without any change in supply at all. In a growing country, or for a commodity for which demand is growing, there may be no actual decrease in supply, but only a cessation of increase. Demand is simply allowed to catch up with the new situation.

All this supposes that the industry is in a normal state at the time when the tax is imposed, — that the capitalists engaged in it are making normal profits, and will be led to lessen their output, some of them perhaps even to withdraw entirely if their profits are cut down. But it is perfectly possible that a tax may be imposed at a time when an industry is unusually profitable. Then its effect may be apparently on the producers only; they may be able to pay the tax, and still sell to consumers at the ordinary profit. What happens in such cases is not that the consumers pay a higher price, but that they are prevented from getting the lower price which competition would eventually have brought about. This process is, of course, much more convenient to the producers

than that of imposing a tax when an industry is in its normal state; but evidently it constitutes no real exception to the rule, that the tax eventually falls on the consumer.

Some industries are so much of an aleatory sort that the working of competition, and therefore of taxes, on their products is irregular and uncertain. This seems to be in no small degree the situation as to breweries, which depend for the sale of their product very much on reputation, trade-mark, and the control of dramshops. A brewery is apt to be either a highly profitable enterprise or a disastrously losing one; much as is the alternative in the case of a large hotel or a city newspaper. A tax on beer at a moderate rate is likely to be swallowed up in the oscillations of brewery expenses and profits, and to have hardly a noticeable effect on the retail price of the brewerage. Similarly, a reduction in an existing tax may simply lessen the brewer's expenses by so much, and not affect the retail price. Evidently, this would be true only of moderate charges. A large increase or decrease of tax would be felt by the consumer without question. And even moderate charges would necessarily show their effects in time, though very likely not so much in altered retail prices as in a decrease or increase (as the case may be) of the customary contents of the glass, or in a better or worse quality of the contents. Here, as in almost all economic phenomena, we have to deal with tendencies that work out their results more or less slowly, and in ways often obscure. It is to be said, however, that taxes work out their effects on prices more quickly and surely than some other influences, such as, for example, improvements in production or deficiencies in the supply of materials; since taxes are notorious, and the attention of all producers and dealers is at once fastened on them.

§ 3. Consider now some other cases, less simple. The taxed commodities may be produced under the conditions, not of constant returns, but under those of increasing or of diminishing returns; or they may be subject to a monopoly.

The strict theory of these cases, again, is comparatively easy to work out, being only an application of the general theory

of value.[1] A tax on a commodity produced under diminishing returns may not raise its price by the full amount of the tax. A rise in price can come only with a decline in quantity produced. But, in the case of diminishing returns, a decline in quantity produced means a recession of the margin of cultivation, and a lowering of marginal cost. The effect of the tax in raising normal price is therefore partly offset by the lower cost due to less pressure on the sources of supply. Conversely, a tax on a commodity produced under increasing returns may not only raise its price, but raise it by more than the amount of the tax. In this case the rise in price, by checking consumption and lessening the amount produced, causes the cost per unit to advance, and so the price to rise still further. The same sort of reasoning may be applied to the remission of an existing tax. Where the remission is on a commodity produced under diminishing returns, it is likely to increase consumption, to bring pressure to bear on the sources of supply, to raise marginal cost, and so to lower price by less than the amount of the tax remitted. On the other hand, a tax remitted under increasing returns, by stimulating consumption and output, is likely to cause a decline in cost per unit, and so a fall in price greater than the mere remission alone would have brought about.

A tax on a monopolized article — to pursue the theory of these cases — is not shifted under the same influences and probably not to the same degree as a tax on an article produced under free competition. A tax directly on monopoly profits cannot be shifted at all, just as a tax on economic rent cannot be shifted at all. The monopolist presumably will have adjusted his output in such a way as to secure the maximum profit, just as the owner of an advantageous plot of land presumably will have got the maximum rent; and tax levied directly on monopoly profits or on rent does not open any possibility of adjusting matters in a more lucrative way. The monopolist or landowner must bear the tax with the best grace he can.

[1] See the statement of this theory in Book II, especially Chapters 12, 13, 14, 15.

But a tax on a monopolized commodity is not the same as one on monopoly profits. It is a tax per unit of output, not on the net monopoly gains. The tax on the commodity is much easier to levy, since it is comparatively simple to ascertain what the output is. It is very difficult indeed to measure monopoly profits with accuracy, and correspondingly difficult to assess a tax simply on the monopoly gains. The tax on the monopolized commodity, however, though simple and comparatively certain in its financial outcome, is much more uncertain in its eventual result on prices. It affects at once all the calculations of the monopolist. His expenses of production per unit rise. If he tries to raise his price correspondingly, he will almost surely have to face a decline in consumption. If demand is elastic, this decline in consumption may be considerable, and he is likely to shoulder the tax in good part (*i.e.* not raise his price by the full amount of the tax) rather than incur the decline in profit from a lessening of sales. If demand is inelastic, that is, if a rise in price checks his sales but little, he is more likely to be able to shift a large part of the tax on the consumers.

Theoretic reasoning on this topic may be easily pushed further still. The monopolist may be conducting his business under constant returns, or diminishing returns, or increasing returns. His calculations will be accordingly affected. If he is producing under diminishing returns, a tax and a rise in price, and a check in consumption, will be less unwelcome to him; since with a lessened quantity he will also have lessened costs. If, on the other hand, he is producing under increasing returns, a rise in price and a consequent decline in consumption and output will be very unwelcome to him; since it will bring an increase in his cost per unit. If we suppose him to be quite unfettered in his monopoly, rigorously determined on the extraction of the utmost profit possible, and thoroughly informed both as to the conditions of demand and as to his own increasing or diminishing costs, — then he has a very pretty problem before him in readjusting his supply and his price after the imposition of the tax. He may be supposed to call mathemat-

ical formulæ to his aid, and to work out with exactness how far it will be to his advantage to submit to some part of the tax, how far to shift part of it to consumers.

The very statement of this last case points to an important limitation on the value of all such analysis. There is danger of making an intellectual plaything out of intricate reasoning on the play of demand, varying costs, taxes, and the like. Some economists have given no small share of attention to problems of this kind, forgetting that their reasoning is purely hypothetical and that there is little that corresponds to it in the concrete facts of life. All economic principles hold good only in the rough. Semi-mathematical reasoning, even pure mathematical reasoning, not infrequently aids in bringing out with clearness the underlying principles; but it can rarely be pushed with advantage into details. It cannot be so pushed with reference to the incidence of taxes, — neither as to the modifications of incidence due to increasing or diminishing returns, nor as to the effects of taxes on monopolized articles. Increasing or diminishing returns show themselves slowly and irregularly, and over long periods. Taxes on commodities affected by these varying conditions are maintained only in very few cases, if in any, at a uniform high rate for so long a time as to influence sensibly marginal cost. For most practical purposes, we may content ourselves with the simple result reached at the outset, under the supposition of constant returns, — a tax on a commodity tends to be shifted to the consumer by its full amount. And in the same way we can dismiss most of the complicated reasoning as to the working of taxes on those commodities which are commonly spoken of as monopolized. It has been noted elsewhere[1] that complete monopoly is rare. Those cases in which monopoly is supposed to exist are almost invariably much limited, — limited by substitutes, by potential competition, by public opinion, by force of law. A tax on commodities produced by a quasi-monopoly is not shifted with the same certainty as one upon a competitive article; but there

[1] See Book II, Chapter 15, § 6.

is a strong probability that most of the tax will be shifted in the same way. This sort of rough and general conclusion is alone in accordance with the usual state of the facts; and it suffices for the guidance of the legislator.

§ 4. Taxes on imports present no peculiarities, so far as taxation proper is concerned. They are simply one form of taxes on commodities, and what has been said in the preceding sections applies to them. They are commonly shifted to the consumer, and are meant to be so shifted. In the controversy about protection, zealous advocates of high duties are led occasionally to maintain that taxes on imports are borne, not by the domestic consumer, but by the foreign producer. This may sometimes be the case, just as it is sometimes the case that an internal tax is borne for a longer or shorter period by the producer, and not the consumer. Occasionally, where the producer (domestic or foreign) has a monopoly, he may bear a part of the tax, —conceivably may bear the largest part of it. Sometimes, he seems to bear it, though he does not do so in fact. He sells the commodity at the same nominal price, but with shorter measure or poorer quality. Most often of all, the same unconcealed and simple result ensues, both from internal taxes and customs duties, — the commodity rises in price by the full amount of the tax.

The peculiarity of duties on imports is merely that they may bring into the market a rival untaxed supply. Levied strictly with a view to their effects as taxes, import duties should always be accompanied by internal taxes at the same rates on the same commodities. If this is not done, domestic production may spring up, even though the domestic producers cannot bring the article to market at as low a price as it could be imported for, in the absence of the duties. Whether such a stimulation of domestic production is wise or not, raises the whole question, already sufficiently discussed, of the effect of protective duties.[1]

§ 5. Though the consumer almost always pays taxes on commodities, he is commonly little aware of it. The tax is paid

[1] See Book IV, and especially Chapters 36, 37.

by him in the form of a higher price. When a given price level is established for any commodity, people get used to it as the going rate, and pay without grumbling. If every purchaser had to hand out directly two cents each time he bought a pound of sugar, or was called on to pay a tax of two dollars each time he bought a suit of woolen clothes (such were roughly the rates at which American consumers of these articles were taxed for half a century), — we may be sure that a mighty protest would arise. The fact that such taxes are concealed and but half understood, makes them tempting for the legislator. He is constantly confronted by demands for heavier outlay, and yet finds the public willingness to bear new burdens lagging behind its demands for greater public services. He is likely to turn to the taxes which will yield the largest revenue with the least protest. Such are taxes on commodities.

Obviously, commodities which are produced in the greatest quantities are those likely to yield the largest revenue; and these, again, are likely to be commodities consumed in larger proportion by the poor than by the rich. Hence most taxes on commodities tend to be not even proportional; they are regressive. A poor man, doubtless, will not purchase as much sugar as a rich one; but he will spend a larger share of his income on sugar; and a tax on such a commodity bears more heavily on him. It is doubtless not impossible to select for taxation commodities used chiefly by the well-to-do and the rich, such as laces and champagne. But taxes of this kind are rarely productive of much revenue. The very fact that a person is rich brings it about that he distributes his expenditure over many things, and buys and consumes comparatively little of any one thing. Taxes on luxurious articles hence are likely to yield only driblets of revenue, and to be expensive of administration. The lucrative revenue-yielders are the staples consumed in great amounts, and consumed chiefly by the masses. Such are, to mention articles now much taxed in civilized countries, sugar, tea, coffee, petroleum, tobacco, beer, wine, spirits. On these, to repeat, the taxes are commonly regressive.

Two sets of articles among those just mentioned are usually subjected to taxes, whether excise or customs, at an especially high rate, — alcoholic liquors and tobacco. It is supposed that a decline in their consumption is to be desired rather than regretted, and that taxes may be imposed on them without compunction. This attitude, to be sure, does not go far to explain the taxation of tobacco, nor that of wine and beer on the Continent of Europe, where these beverages are universally used and not greatly abused. Simple fiscal convenience is the main factor. For whatever reason, large revenues are secured in almost every civilized country from such taxes. They are made to yield probably the very largest revenue by creating fiscal monopolies. That is, governments undertake their manufacture, or at least their sale at wholesale or retail, and prohibit all individuals from engaging in the business thus appropriated. Prices are charged to purchasers which are so high as to bring large profits; the result for consumers being the same, though reached by a different process, as that of taxing the commodities in the ordinary ways. Tobacco is a fiscal monopoly in France, Italy, Austria, Spain, and other countries. Spirits are a fiscal monopoly in Russia and in Switzerland. Salt is a fiscal monopoly in Austria and Italy. This method has the advantage that evasion is easily detected; the very fact that any private individual conducts the business at all is proof that he violates the revenue law. On the other hand, the system is open to all the objections to bureaucratic administration, and in particular is the more unsuitable as the civil service is ill organized and the general tone of public administration is lax.

Customs duties are made more easily applicable to a large and varied list of articles than excise taxes. Supervision need not extend over the whole land; it can be limited to the ports of entry into the country. This circumstance goes far to explain the wide prevalence of protective duties. They are a convenient way of getting revenue. Once adopted for revenue, their incidental effects on the course of domestic industry are at first

overlooked, and then, when they have established themselves, are welcomed. The list of articles on which customs duties are levied in the United States is an extraordinarily wide one, covering some 1500 different things. It would be out of the question to levy excise taxes on any such list.

In fairness, it is to be said of the customs duties in the United States, as they developed under the extreme protectionist system so long maintained, that their incidence was not so clearly bad as is commonly the case with excises. Tea, coffee, cocoa, were free of duty. Sugar was the only dutiable article of food whose taxation was clearly regressive. What was true of sugar, was probably true also of wool, the duty on which was perhaps the most objectionable of all the protective duties. As regards manufactured commodities, many were not affected by the duties, directly or indirectly. The commoner grades of cotton goods, for example, are produced as cheaply within the country as abroad; they would not be imported in any case; duties on them, though they stand on the statute book, are merely nominal. The finer grades of cotton fabrics are largely imported, or are made within the country under the shelter of the duties. The prices of these are raised by duties, and a real tax is imposed on consumers. But the consumers are, if not wholly, at least to a great degree, the well-to-do and rich, and such a tax is in so far not open to the objection of bearing with special weight on persons of small means. The same is probably true of duties on other textiles, such as woolens and silks; though as to these it is not so clear that duties on the cheaper qualities are merely nominal. The main objection against our régime of high protection was not so much that it caused disproportionate burdens on those least able to pay, as that it gave a disadvantageous direction to the productive energies of the community.

References on Book VIII

C. F. Bastable, *Public Finance* (2d ed., 1895), covers the whole field, and is able and well-judged, though not attractively written. Among foreign books, K. J. Eheberg, *Finanzwissenschaft* (new ed., 1909), is a good book of the German type; and P. Leroy Beaulieu, *Science des Finances* (new ed., 1906), is an able French book, full of good sense and information, but not strong on some questions of principle. On progression, the view presented in Chapter 66 is similar to that of A. Wagner, *Finanzwissenschaft*, Vol. II, § 396 *seq.* (ed. of 1880), and is different from that in E. R. A. Seligman's *Progressive Taxation in Theory and Practice* (new ed., 1908). The last-named writer's *Income Tax* (1911) is an excellent survey of legislation and experience; and in his *Essays on Taxation* (new ed., 1911), there is a valuable discussion of the American property tax system. A mass of discussion and information, uneven in quality, but highly useful on American conditions, is in the *Proceedings of the National Tax Association*, published annually since 1907.

INDEX

(Reference should also be made to the analytical Table of Contents at the beginning of Volume I.)

"Ability" principle of taxation, ii, 488.
Abstinence in relation to interest, ii, 41; under socialism, ii, 457.
Accident, insurance against, ii, 323; bad legal situation in United States, ii, 335.
Acworth, ii, 478.
Adams, T. S., ii, 359.
Advances to laborers, in relation to capital, i, 74.
Advertising, and large scale production, i, 54, 65; how far serves a good purpose, i, 20, ii, 428.
Agrarstaat, argument for in Germany, i, 534.
Agricultural implements, statistics on manufacture, i, 49.
Agricultural land, incidence of taxes on, ii, 517, 535.
Agriculture, no tendency to large scale production, i, 56; subject to diminishing returns, i, 186; coöperation in, ii, 354, 356; position under socialism, ii, 447.
American specie, in sixteenth century, i, 248, 255.
American Sugar Refining Company, *see* Sugar.
American Tobacco Company, i, 62, ii, 386, 428.
Andrew, A. P., i, 445.
Anthracite coal, tendency to overproduction, ii, 52; diminishing returns in mines, ii, 95.
Apprenticeship obsolete, i, 103.
Arbitration, *see* Contents, ch. 57.
Arkwright, i, 34.
Army and Navy Stores, ii, 347.
Ashley, W. J., i, 547.
Assignats, i, 313.
Astor, J. J., ii, 99.
Atkinson, F. J., i, 247.
Australia, gold discoveries in, i, 258, 276, 442; effects on foreign exchanges, i, 474; labor legislation in, ii, 302, 317; old age pensions, ii, 332; railways, ii, 412.
Austria, peculiar position of silver florin, i, 324.
Axes, conventional, used as money, i, 230.

Babbage, i, 110.
Bailey, ii, 216.
Bank Act of 1844 (England), i, 365, 417.
"Bank money," i, 393.
Bank notes, *see* Contents, chs. 24 to 28; effect of small denominations, i, 335, 435.
Bank of England, description of, i, 365; policy of, during crises, i, 369, 414, 422, 434; how gold bullion provided, i, 453.
Bank of France, notes inconvertible yet not depreciated, i, 321, 362; description of, i, 361.
Bank of Germany, *see* Reichsbank.
Banks of the United States, first and second, i, 397; effects on domestic exchange, i, 467.
Barings, i, 95, 332, 415.
Barnett, ii, 359.
Bastable, C. F., i, 540, ii, 561.
Bedford, Duke of, ii, 87, 99.
Bedford level, ii, 70.
Berlin, birthrates in different quarters, ii, 227.
Bernstein, ii, 475.
Bertillon, ii, 216, 228.
Bessemer, i, 197, ii, 108.
Beveridge, ii, 360.
Bill brokers in England, i, 350.
Bill of exchange, i, 428.
"Billon" coins, i, 273.
Bimetallism, *see* Contents, chs. 20, 21.
Birthrates, general statement, ii, 210; figures for various countries, ii, 215; for United States, ii, 219; for Massachusetts, ii, 219; general decline in nineteenth century, ii, 223, 230;

variations between rich and poor quarters, ii, 227; between native born and foreign born, ii, 228, 232.
Böhm-Bawerk, ii, 6, 11, 36, 257, 478.
Bonanza farming, i, 56.
Bonanza mines of Nevada, ii, 93.
Bonar, ii, 257.
Bonds, taxation of, ii, 537; effect of exemption, ii, 543.
Booth, Charles, ii, 241, 242.
Boots and shoes, exported from United States, i, 543.
Boston, birthrates in different quarters, ii, 228.
Boulton, ii, 165, 402.
Bowley, ii, 240, 244.
Branch banking, i, 399.
Brassey, ii, 402.
Brentano, L., i, 547.
Breweries, in relation to taxation, ii, 553.
Briggs collieries, ii, 304.
Brokers, productive or unproductive, i, 26.
Bücher, i, 52, 110.
Bureau of Corporations, investigation of railway rates, ii, 414; powers should be increased, ii, 438.
Business leadership, effect on industrial efficiency, i, 105.
Business profits, *see* Contents, chs. 49, 50; how affected by rising prices, i, 303.
Butcher's trade, in relation to division of labor, i, 42.
"By-products," utilization in large establishments, i, 54; explained, i, 219.

Cairnes, ii, 134.
California, gold discoveries in, i, 258, 276, 442; paper money fails to circulate in, i, 312; effects of gold production on foreign exchanges, i, 474.
Call loans, fluctuations in rates, i, 353.
Caloric engine, ii, 165.
Canada, banking system, i, 383; government note issues, i, 328; trade with United States, i, 478, 509.
Capital, *see* Contents, chs. 5, 38–40, 46; moral and intellectual, i, 108; not created by banks, i, 357; productivity of, ii, 7; marginal productivity of, ii, 9; definition of, ii, 35; sometimes classified as artificial and natural, ii, 118; how accumulated under socialism, ii, 457.
Capital goods, i, 84; how influenced in value by marginal utility, i, 151.
"Capitalistic" production, ii, 6.
Carnegie, i, 58.
Carver, ii, 11, 257.
Cattle, a medium of exchange, i, 114.
Central bank, able to mitigate crises, i, 413; how far protects specie holdings, i, 459.
Central reserve cities, i, 377.
Check, legal position of payee, i, 387.
Chevalier, i, 307.
Chicago Board of Trade, clearing system, i, 430.
Children, high death rate, ii, 216.
China, silver bullion as money in, i, 231; merchants' notes as money, i, 429.
Chinese, exclusion from United States, how justified, ii, 140.
Civil Service Supply Association, ii, 347.
Clare, G., i, 546.
Clark, J. B., i, 446, ii, 10, 11, 119, 257.
Clark, J. M., ii, 478.
Clark, V., ii, 317, 359.
Clearing house certificates, i, 420.
Clearing houses, i, 342; connection with theory of prices, i, 430.
Closed shop, ii, 269, 276.
Coffee, *see* Tea.
Coinage explained, i, 230.
Cold storage, effect on conditions of supply, i, 145, 161.
Collective bargaining, ii, 276.
Colson, ii, 478.
Combination, horizontal and vertical, i, 59, 60.
Commons, J. R., i, 42.
Communistic societies, ii, 443.
Comparative cost, doctrine of, i, 482.
Competition, its efficacy important for the classification of capital, ii, 120.
Competitive margin for capital, ii, 20.
Comptoir d'Escompte, i, 402, 415.
Compulsory arbitration, ii, 316.
Conant, C. A., i, 445.
Constant cost, i, 172; effect of taxes on commodities under, ii, 552.
Constitutional limitations, on labor legislation, ii, 292; on income taxes, ii, 512.
Consumer's capital (consumer's wealth) not commonly regarded as capital, i, 83; how it yields interest, ii, 33–37.
Consumer's surplus, i, 128.
"Continental" paper money, i, 313.
Continuous demand, i, 140.

Convertible government paper, i, 326.
Cooke (Jay) and Company, i, 402, 410.
Coöperation, *see* Contents, ch. 59.
Copper, corner of 1888, i, 217; successive discovery of mines, ii, 95.
Copyright books, illustrate monopoly value under decreasing cost, i, 207, 209; a qualified monopoly, i, 213; justification of, ii, 109.
Corner, operations analyzed, i, 214.
Corporations, *see* Contents, ch. 6; honesty of management, i, 94; connection with crises, i, 409; *see also* Bureau, and Public Service.
Corporation taxes, Federal, ii, 513; by states, ii, 536.
Cost of production, in what sense used, i, 171, 186, ii, 147.
Cotton, fiber and seed illustrate joint cost, i, 218, 220; why exported from United States, i, 485.
Cotton goods, statistics on manufacture, i, 50; effect of United States duties, ii, 500.
Cotton market and prices, i, 147, 151.
Craft gilds, i, 39.
Credit, use of, effect on prices, i, 427.
Crédit Lyonnais, i, 35.
Crises, *see* Contents, chs. 29, 30; policy of Bank of England during, i, 369, 414; periodicity of, i, 400; sun spot theory of, i, 401; advantage of a central bank for mitigating, i, 413; possibly mitigated by combinations, ii, 433.
Crisis of 1857, i, 413.
Crisis of 1873, i, 402, 408, 420, 424; connected with railway building, i, 410; connected with international borrowing, i, 471.
Crisis of 1893, i, 401, 407, 421.
Crisis of 1907, i, 401, 410, 420.
Crompton, i, 34.
Crops, connection with crises, i, 406, 407.
"Crossing" of checks in England, i, 344.
Cuban sugar lands, predatory cultivation of, ii, 66.
Custom, effect on retail prices, i, 153.
Cutthroat competition, ii, 427, 429, 435.

Darwin, C., ii, 131, 210.
Darwin, L., i, 445, ii, 478.
Death rates, general statement, ii, 210; figures for various countries, ii, 215; for United States, ii, 219; for Massachusetts, ii, 219.
De Beers company, i, 204.
Delano, F. A., ii, 370.
Demand curve, i, 141.
Demand loans by banks, i, 353.
Denmark, coöperation in, ii, 354.
Depew, town of, ii, 90.
Depositors, relation to banks, i, 387, 389.
Deposits, *see* Contents, chs. 24–28, 31; relation to circulating medium and to checks, i, 310, 431.
Depreciation of machinery and maintenance of capital, i, 77.
Derived value, ii, 117.
Deutsche Bank, i, 373.
Dewey, ii, 254.
Dexterity, how far cause, how far result of division of labor, i, 32.
Diamonds, in relation to consumer's surplus, i, 130; illustrate monopoly value, i, 204, 208.
Dickinson, G. L., ii, 479.
Dietzel, H., i, 547.
Differences of wages, *see* Contents, ch. 47.
Diminishing returns, relation to value, i, 185; in agriculture, i, 186; how far in gold mining, i, 262; as to capital, ii, 11; on any one plot of land, ii, 59, 62; on urban sites, ii 80; taxes on commodities produced under, ii, 554.
Diminishing utility, principle of, i, 122.
Direct taxes, constitutional sense of, ii, 512; relegated to local bodies in Prussia, ii, 527; economic sense of, ii, 550.
Discharge, right of, essential, ii, 275; disappears under socialism, ii, 462.
Discontinuous demand, i, 140.
Discount by banks, how calculated, i, 338.
Discounted product of labor, relation to wages, ii, 198.
Diskonto-Gesellschaft, i, 373.
Division of labor, *see* Contents, ch. 3.
Domestic exchange, i, 466.
Domestic servants, *see* servants.
Double standard, i, 266.
Double taxation, ii, 537.
Dresdner Bank, i, 373, 415.
"Dry farming," ii, 69.
Dumont, ii, 257.
"Dumping," i, 211.
Dunbar, C. F., i, 445.
Dutch East India company, destruction of crop by, i, 204.

Duties on imports, fiscal effects, ii, 557, 559, *see also* Protection
Dwellings rental of, a form of interest, ii, 33, demand possibly discontinuous, i, 158, incidence of taxes on, ii, 518, 535
Dynamic state, i 175

Economic area, i, 40
Economic goods, i, 3, 5
"Economic rent ii 56
Edgeworth F Y, i, 445, 546
Edison, ii, 164, 402
Education effect on efficiency, i, 101, expense of, doubly affects wages, ii, 127
Egypt, usury in, ii, 30
Eheberg, ii 561
Eight-hour day, ii, 293
Einaudi L, ii, 96
Elastic demand i 141
Elasticity of bank issues, i, 390
Ely, ii, 478
Emergency currency, i, 390, (act of 1908), 422
Employment not created by protection, i, 511
England, rate of interest in eighteenth century, ii, 26, *see also* Great Britain
Entrepreneur, ii, 158
"Equal pay for equal work," ii, 144 282
Equality of sacrifice, as a principle of taxation ii, 489
Equalizing cost of production, as a principle of protection, i, 516
Equalizing differences of wages, ii, 124
Equation of supply and demand, i, 143
Erdmann Act, ii 321
Ericsson, i 41, ii, 165
Erie canal, free of tolls, ii, 365
Eugenics, i, 109, ii, 235
Excess of exports from United States since 1873, i, 475, of imports till 1873, i, 475
Exchange, how developed i 164
Exchange and division of labor i, 38
Excise, ii, 551
Expenditure on luxuries, effect on wages, ii 193
Expenses of production, in what sense used, i, 172 ii, 147
Extensive cultivation, ii, 67.
External economies, i, 192

Factory acts, ii, 286
"Faculty" principle of taxation, ii, 488
"Fair price," i, 155.
"Fair wages," ii, 313
"Favorable balance of trade," i, 476.
Fawcett H, i, 546
Fay, ii 360
Federal incorporation, ii, 439.
Federal Reserve Banks, i, 379.
Fetter, ii, 257
Fiat money, i, *310*
Fiscal monopoly, i, 212
Fisher I i 445, 446, ii, 119, 257.
Fitch ii, *275*
Fixed prices (retail), advantages of, i, 155
Florin, peculiar position of in Austria, i, 324
Flour milling, how affected by dealings in futures i, 162
Foreign exchanges, *see* Contents, ch 32
Forests, varying conditions of supply, i, 187
Fortunes, easily maintained in modern times, i, 96
France, cooperative production in, ii, 356
France preventive check in, ii, 218
Frankel ii, 300
Free Goods, i 3 5,
Free Trade *see* Contents, chs 36, 37; summary statement of main argument, i, 503
Freight charges, effects on imports and exports i 473
Freight classification on railways, ii, 371
French peasantry, hoarding by, i, 73
Friendly societies, ii, 328
Fulton i, 35
Funded incomes, to be taxed at higher rates ii 490
Futures speculation in, i, 161, 167.

Gary, town of ii, 89
General property tax, *see* Contents, ch. 69
Geographical division of labor, i, 43, 494, how affected by railways, ii, 364, 373
Germany, workmen's insurance in, *see* Contents, ch 58, growth of large scale production, i, 51
Ghent system of unemployed benefit, ii, 339
Glasgow bank failure, i, 90
Glass blowers' union, i, 522, in relation to marginal utility, ii, 149, former monopoly position, ii, 267.
Godin, ii, 304, 305.

Gold, articles made of, how affected by rising and falling prices, i, 242.
Gold and silver, how fitted for medium of exchange, i, 115, 228; industrial consumption of, i, 244, 245; how durability affects value, i, 252; production aleatory, i, 253, yet less so in modern times, 254; how far subject to diminishing returns, i, 262; mining countries export specie, i, 461, 473.
Goldsmiths, the first London bankers, i, 336.
Gold standard, adopted in England, i, 274; in Germany, i, 278; United States legislation of 1900, i, 328.
Good will, effect on value, i, 177.
Goshen, G. J., i, 546.
Gould, ii, 390, 392.
Government employees, high pay of, ii, 126, 408.
"Government stroke," ii, 408.
Graebe, I, 106.
Great Britain, and geographical division of labor, i, 43, 44; system of customs duties, I, 520; contemporary tariff controversy in, i, 536; investments in foreign countries, i, 470; international trade illustrated, i, 495; distribution of incomes, ii, 240; of property, ii, 243; causes of success in coöperation, ii, 350, 357, income tax system, ii, 501, 511, 544; inheritance taxes, ii, 510; local taxes, how levied, ii, 522, 542.
"Greenbacks," i, 327.
Gresham's law, i, 269.
Ground rents and leases, ii, 86, 87.

Hadley, A. T., ii, 478.
Hamburg, birth rates in different quarters, ii, 227.
Hammond, M. B., ii, 478.
Hargreaves, i, 34.
Hedging, i, 162.
Helfferich, i, 253, 445.
Heredity, i, 109.
Hill, R., ii, 400.
Hindustan, usury in, ii, 30.
Hoarding, i, 73.
Holding company, ii, 421, 439.
Holland, rate of interest in eighteenth century, ii, 26.
Hollander, ii, 359.
Home market argument for protection, i, 510.
Horizontal combination, i, 59, 194.
Hours of labor, regulation of, ii, 291; influence of shorter hours on wages, ii, 294.
Hurd, ii, 257.
Hutchins, ii, 259.
Hutchinson, W., ii, 143.

"Illegitimate" profits, ii, 187, 493.
"Illegitimate" speculation, i, 166.
Immigrants, how remittances affect imports and exports, i, 472; low rates of wages, i, 491, ii, 139, 234.
Immobility of labor, how affects international trade, i, 490; influence on bargaining power of laborers, ii, 264.
Income of a community, how measured, i, 133.
Income taxes, *see* Contents, ch. 67.
Inconvertible paper money, *see* Contents, ch. 23; foreign exchange under, i, 464
"Inconvertible specie" in British India and in Austria, i, 323.
Increasing returns, i, 189; on railways, ii, 367; effect of taxes on commodities produced under, ii, 554.
Increment taxes, ii, 10_, in Germany and Great Britain, ii, 103; modes of levying, ii, 104.
Indestructible powers of the soil, ii, 65, 68.
Index numbers, explained, i, 291; arithmetic mean, i, 291; geometric mean, i, 292; median, i, 292; weighted mean, i, 293; proposed regulation of money by, i, 442.
India, English rule in, i, 25; hoarding in, i, 73; drain of specie to, i, 245; silver coinage stopped in 1893, i, 284; value of rupee, i, 323; foreign exchanges under rupee standard, i, 462.
Indirect taxes, ii, 550.
Industrial Revolution, i, 35, ii, 31.
Industriestaat, argument against in Germany, i, 534.
Inelastic demand, i, 141.
Inequality, *see* Contents, ch. 54.
Inheritance, importance for distribution, ii, 247; justification of, ii, 248, 509.
Inheritance taxes, ii, 507.
Instinct of acquisition, i, 122.
Instinct of contrivance, i, 72.
Insurance, workmen's, *see* Contents, ch. 58.
Insurance of deposits, i, 389.
"Intangible" property, under general property tax, ii, 533, 542.

Integration of Industry, i, 60.
Intensive cultivation, ii, 67.
Intention of the owner and making of capital, i, 80.
Interest, general statement, *see* Contents, chs. 38–40; preliminary statement concerning, i, 79; how affected by changing prices, i, 306; not affected by quantity of money, i, 352; how affected by bank reserves, i, 353; how related to quantity of money, ii, 5; possibly negative, ii, 17; steadiness of rate in modern times, ii, 26; why prohibited in medieval times, ii, 31; on durable goods such as dwellings, ii, 33; variations between different regions, ii, 38; justification of, ii, 41; how rate determines selling price of land and securities, ii, 97; how related to business profits, ii, 179, 183; how far rate is affected by taxation, ii, 547.
Internal economics, i, 193.
Internal tax, on commodities, ii, 551.
International bimetallism, probable effects, i, 286.
International borrowing, effects on imports and exports, i, 468, ii, 38.
International Harvester Company, i, 53.
International Paper Company, i, 02.
International paper money, i, 326.
International trade, *see* Contents, Bk. IV; connection with theory of prices, i, 439; extent of gain from, i, 503; how related to non-competing groups, ii, 155.
Invention promoted by corporations, i, 90.
Investment, in relation to saving, i, 74.
Iron, how far supply elastic, i, 150.
Iron and steel manufacture, statistics on, i, 50; transformation since 1890, i, 58; annual output since 1800, i, 69; elaborate plant, i, 71.
Italy, international trade illustrated, i, 495.

Japan, international trade illustrated, i, 487.
Jenks, ii, 478.
Jevons, i, 401, 445, ii, 10, 405.
Jews, why money-lenders in medieval times, ii, 31.
Johnson, A. S., ii, 118.
Johnson, E. R., ii, 478.
Johnson, J. F., i, 445.
Joint cost, theory of, i, 218; application to railways, ii, 369.
Joint demand, i, 222.
Juglar, C., i, 446.

Kartell, ii, 423.
Kautsky, ii, 478.
Kingsley, Mary, i, 230.
Knickerbocker Trust Company, i, 402.
Krupp, i, 58.
Kuczynski, ii, 232.

Labor, what is meant by, i, 8; productive and unproductive, i, 15; predatory, i, 20.
Labor legislation, *see* Contents, ch. 56; how far socialistic, ii, 455.
Labor supply, a cause of external economies, i, 193; in building operations, illustrates joint demand, i, 222.
Labor theory of value, ii, 148.
Laborers, unskilled, why wages low, ii, 138; would be high if scarce, ii, 171.
Landry, ii, 257.
Land taxes, *see* Contents, ch. 68.
Land tenure, *see* Contents, ch. 42.
Large scale production, *see* Contents, ch. 4; connection with combination, ii, 430.
Latin Union, i, 278.
Laughlin, J. L., i, 445.
Law, in relation to productive labor, i, 28.
Law's notes, i, 313.
Lawyers, productive laborers, i, 23.
Leclaire, ii, 304, 305, 307.
"Legitimate" business, i, 29.
"Legitimate" profits, ii, 187.
Le Rossignol, ii, 478.
Leroy Beaulieu, P., ii, 561.
Levasseur, ii, 257.
Lewis and Clark's expedition, i, 131.
Liebermann, i, 106.
Liefmann, ii, 434, 378.
Leisure class, how it emerges, ii, 253; justification of, ii, 253.
Limitation of output, ii, 272.
Limited liability, i, 86.
Limited coinage in 1878 and 1890, i, 282, 283.
Limping standard, in France, i, 280; in Germany, i, 280; in United States, i, 281.
List, F., i, 527, 528.
Living wage, a hazy notion, ii, 299; in relation to taxation, ii, 499.
Locke, ii, 251.
London, birthrates in different quar-

ters, ii, 227, 229; distribution of incomes, ii, 241, 242.
Long and short haul, ii, 374.
Lowell, ii, 410.

Machinery, and identical movements, i, 36; connection with tariff problems in United States, i, 543.
Mackay, ii, 479.
Macrosty, ii, 478.
"Making work," effect on wages, ii, 194; no inducement to, under socialism, ii, 462.
Mallock, ii, 241.
Malthus, ii, 209, 212, 213, 224, 231.
Mantoux, i, 110.
Marginal producers, i, 172.
Marginal utility, i, 125; of money, i, 127, 238; ultimate determinant of value, ii, 151.
Margin of cultivation defined, ii, 59.
Marriage, slight variation of rates, ii, 224; average age of, ii, 226.
Marshall, i, 182, 191, ii, 96, 173, 176, 257.
Marx, ii, 50, 337, 445, 450, 473, 474, 478.
Massachusetts, birthrates of foreign born and natives, ii, 232; Ten Hour Act, ii, 287; mill conditions in earlier times, ii, 288; railway commission, ii, 414; methods of taxation, ii, 533, 536.
Maximum happiness, i, 135.
Mayr, ii, 224, 257.
Meade, ii, 478.
Medium of exchange, i, 114, 227.
Mercantilism, i, 476, 509, 538.
Mergenthaler, ii, 108, 109.
Metals, relative production of different, i, 229.
Metayer tenure, ii, 72.
Mexican silver supply, i, 256.
Meyer, R., ii, 241, 246.
Michigan, birthrates of native born and foreign born, ii, 228.
Milk, wasteful competition in supply, i, 65; "postage stamp rate" on, ii, 60.
Mill, J. S., i, 110, 240, 546, ii, 102, 148 237, 250, 296, 399.
Mines, subject to diminishing returns i, 187; rent of, ii, 92.
Minimum for efficiency, i, 100.
Minimum wages, ii, 299; in relation to taxation, ii, 499.
Mint price of gold, i, 233.
Mitchell, W. C., i, 295, 319, 445.
Mombert, ii, 228.
Money, Chiozza, ii, 241, 244.
Money, *see* Contents, Bk. III; what is meant by the term, i, 386, 387, 444; under socialism, ii, 449.
Money incomes, wherein high range advantageous, i, 498, 504, ii, 156.
Monopoly, *see* Contents, chs. 15, 45, 63; how connected with internal economies, i, 194; profit defined, i, 202; industrial, ii, 107; gains sometimes defined as a kind of rent, ii, 116; of labor, ii, 128, 266; the essential characteristic of public service industries, ii, 398, 407; what are earmarks of, ii, 440; effect of tax on monopolized commodities, ii, 554; fiscal, ii, 559.
Morgan, i, 95, 332, ii, 392.
Mortgages, taxation of, ii, 540.
Moses, i, 312.
Motives of business men, ii, 20.
Multiple standard discussed, i, 301, 443.
Munro, ii, 410.

Napoleon, i, 24.
National banking system in United States, i, 375.
Nelson, N. O., ii, 304, 305.
New York banks, position in American banking system, i, 379, 418.
New York Central Railway, ii, 383.
New York city, value of land in, ii, 79;
New York state, methods of taxation, ii, 533, 536.
Newsholme, ii, 211, 216, 224, 229.
Non-competing groups, described, ii, 134; connection with theory of international trade, ii, 155.
Non-material wealth, i, 19, 20.
Northrop, ii, 108, 109.
Note brokers in United States, i, 350.

Office buildings in American cities, ii, 78, 83.
Ogle, ii, 226.
Ohio Life and Trust Company, i, 402.
Oil, illustrates joint cost, i, 220.
Old-age pensions, ii, 331, 343.
Open shop, ii, 276.
Open union, ii, 267.
Oregon question, in reference to free trade, i, 509.
Osler, ii, 461.
"Outside paper," when bought by banks, i, 355.
Overberg, ii, 257.

Overcapitalization of railways, ii, 385
Overend Gurney and Company, i, 402
Overinvestment, *see* Contents, ch 41, esp ii, 48
Overproduction, *see* Contents, ch 41 easily remedied under socialism, ii 456
Overvalued metal, under double standard, i, 267
Owen, R , ii, 130

Pain economy i, 131
Panama canal illustrates uncertainty of labor s product, ii, 200
"Parasitic" industries i, 486, ii, 156
Pareto, ii, 246
Paris, birthrates in different quarters ii, 2?7
Partnership, legal position of i, 87
Patents articles illustrate monopoly prices, i 209, justification of, ii 108, term of, ii, 108
Patten i 131
Paulsen, ii, 254
Pawnbroker s loans ii 30 40
Pennsylvania how securities taxed ii 534
Perkin, i, 106
Phelps ii 216
"Philanthropy at 4 per cent," ii, 40.
Philippovich, 110
Piecework, ii 272
Pigou, A C i 547
Pioneer cultivation, ii 61
Pleasure economy i, 131
Pohle, L i, 547
Pools among railways ii, 379
Poor Laws ii, 342
Population *see* Contents chs 52 53 movement of within a group ii, 152
Positive checks, ii, 213
"Postage stamp rate," on railways, for milk, ii 60
Postal rate, uniform because of monopoly, i 210, relation to expenses, ii, 400
Potential competition, ii 433
Potosi, i, 256
Predatory cultivation, i, 534, ii, 66
Predatory labor, i 20
"Premium on currency" in 1903 and 1907, i, 421
Prestige value, i, 130
Preventive checks, ii, 213
Price, defined, i, 117
Prices in United States, 1890–1906, i, 295, 1860–80, i, 319.
Printers, how affected by inventions, ii, 196
"Private banks" in Germany, i, 371.
Private property, *see* Property
Prizes, effect on remuneration, ii, 127, 173
Producer s capital, i 70
Producer s surplus, i, 189, ii, 56
Productive and unproductive labor, i, 15
Productivity of capital, ii, 7
Professors' salaries, why low, ii, 125
Profit sharing, *see* Contents, ch 57.
Progressive taxation, ii, 487, 492, as to inheritances, ii, 508
Property, grounds of, *see* Contents, chs 54, 64, 65 in land, ii, 73, 75
Protection *see* Contents, chs 36, 37
Prussia distribution of incomes, ii, 239 of property ii 243, railways give low export rates, ii, 375 purchase of railways ii, 405, income tax system, ii 505, 511
Psychic income i, 135
Psychology, relation to business ambition, ii, 167, to problems of socialism ii 465 470
Public debts, how affected by price changes i, 297, *see also* War debts
Public goods, i 5
Publicity for control of corporations, ii 415, 438
Public ownership *see* Contents, ch 62, how far socialistic ii, 454, how related to taxation ii 484
Public securities taxation of ii, 542
"Public service" industries and corporations i 89 ii, 110, 397
Pullman town of, ii, 89.

Quantity theory of money, i, 237, 427

Race suicide, ii, 236.
Rae ii 359
Raiffeisen ii 354
Railways *see* Contents, chs 60, 61, difficulty of supervising labor, i, 57; construction connected with crises, i 403 407
Rapidity of circulation, as to money, i, 239, as to goods i 240
Ratio (coinage) between gold and silver i, 266 in United States, i, 268; in France, i, 275
Ratio (market) between gold and silver, change after 1873 i 277, course since 1893, i, 285, steadiness of, promoted by bimetallism, i, 277,

286; how probably affected by international bimetallism, i, 287.
Raw materials, give no occasion for protection to young industries, i, 528, 545.
Real estate agents, ii, 83, 87.
Rebates, ii, 379, 426.
Reciprocal demand, theory of, i, 495.
Reciprocity, inevitable as regards shipping, i, 531; with Canada, i, 478, 509; how far expedient for Great Britain, i, 537.
Regressive taxation, ii, 558.
Reichsbank, description of, i, 370.
"Reichskassenscheine," i, 328.
Rent, *see* Contents, chs. 43, 44, 46; theory of, how far applicable to business profits, ii, 172.
Representative firm, ii, 176.
Reserve cities, i, 377.
Resumption of specie payments, in United States in 1879, i, 318; what method desirable, i, 312.
Retail prices, how affected by marginal utility, i, 153; how related to wholesale prices, i, 153; how affected by custom, i, 153; advantages of fixed, i, 155.
Retail trading on large scale, i, 57.
Rhodes, C., i, 204.
Ricardo, ii, 65, 96, 148, 153.
Rising prices, how connected with prosperity, i, 303; effect on wages, i, i, 304; effect on business profits, 303.
Rochdale Pioneers, ii, 348.
Rodbertus, explanation of crises by, ii, 49; on unemployment, ii, 337.
Roscher, i, 110.
Rothschild, i, 95, 332, ii, 41.
Roundabout production, ii, 6, 14.
Rowntree, i, 98.
Royalties on mines, ii, 96.
"Runs" on banks, i, 413, 416.
Rupee in India, i, 323.

Saver's rent, ii, 23; in relation to taxation, ii, 495.
Saving, stimulated by corporations, i, 90; how far dependent on a reward, ii, 16; marginal, ii, 21.
Saving and capital, i, 72.
Savings banks, i, 76.
Scab, ii, 279.
Schaeffle, ii, 479.
Schmoller, ii, 240, 254, 257.
Schulze-Delitzsch, ii, 352.
Scissors, simile of, to illustrate theory of value, i, 182, 191.
Scotch banking system, i, 382.
Seager, ii, 359.
Seasonal price, relation to market price, i, 149.
Securities not capital, i, 83.
Seigniorage, i, 232, 272.
Seligman, ii, 561.
Senior, i, 313.
Servants, high wages in United States, i, 506, ii, 125, 264; per family in London, ii, 241.
Share farming, ii, 72.
Sherman Act, ii, 380, 422, 437.
Shipbuilding in the United States and Great Britain contrasted, i, 192.
Shipping, effects of charges, on imports and exports, i, 473; political arguments for subsidies, i, 530.
Shirtwaist workers, ii, 143.
Sickness, insurance against, ii, 328.
Siemens, ii, 161, 402.
Silk duties in United States, possible effects of, i, 529, 544.
Silver, drain to the East, i, 245; position in sixteenth century, i, 255; production after discovery of America, i, 256; production 1871-1905, i, 285.
Silver certificates, i, 283.
Silver dollar, i, 265, 268; free coinage dropped in 1873, i, 281.
Single tax, ii, 73; with reference to urban land, ii, 98; with reference to mines, ii, 101.
Situation rent, ii, 60.
Skates, American imitated in Germany, i, 543.
Slag, illustrates joint cost, i, 220.
Slatin, i, 231
Sliding scale, ii, 311.
Smith, Adam, i, 41, 110, 248, ii, 44, 130, 180.
Socialism, *see* Contents, chs. 64, 65; attitude toward classification of capital, ii, 119.
Social stratification, ii, 130.
Soetbeer, i, 254, 259.
Soldiers and sailors, productive laborers, i, 24.
Sombart, ii, 240.
South African gold supply, i, 261, ii, 94.
Spahr, ii, 246.
Spargo, ii, 478.
Specie premium, general discussion, i, 316; in United States during Civil War, i, 318; connection with foreign exchange, i, 464.
Speculation, *see* Contents, Ch. 11; in

relation to "corners," i, 215; in real estate, ii, 87; in railway securities, ii, 389.
Spendthrift loans do not lead to capital, i, 81; effects on rate of interest, ii, 29.
Sprague, O. M. W., i, 445, 446.
Stadwirthschaft, i, 39.
Stahlwerkverband, i, 63.
Standardizing, i, 164.
Standard of living, how it affects wages, ii, 221, 229.
Standard Oil Company, i, 221, ii, 378, 386, 414, 421, 424, 427.
Standard rate, of union wages, ii, 273; as to prices, ii, 435.
Stanwood, E., I, 547.
State banks in United States, i, 378, 435.
Static state, i, 175.
Statistics of capital often misleading, i, 85.
Steel Corporation (U. S.), and vertical combination, I, 61; how affected by rising prices, i, 304; ii, 434.
Stephenson, i, 35, 40, ii, 164, 402.
Sterling exchange, i, 451.
Steuart, i, 313.
Stock Exchange operations, i, 26, 93; evils of, i, 167; clearings, i, 430.
Stoppage at the source, ii, 503.
Street railways, uniform fare the result of monopoly, i, 210.
Strikes, violence in, ii, 280.
Subsidiary coin, i, 271.
Subsistence and labor efficiency, i, 98.
Subsoil draining, ii, 69.
Suffolk Bank system, i, 347.
Sugar refining, i, 59, 62; bounties of 1890 in United States, i, 532; Refining Co., ii, 421, 424; taxation in Germany, ii, 550; taxation in United States, ii, 558, 560.
Summum Bonum, ii, 459.
Supply curve, i, 145.
Surnames, illustrating simpler division of labor, i, 31.
Surplus, essential for making capital, i, 71; its accumulation irksome, ii, 16.
"Sweating," ii, 297.
"Sweating" of coins, i, 231.

"Tariff mother of trusts," i, 522.
Taussig, F. W., i, 547.
Tax dodging, ii, 533.
Tea and coffee, British taxes on, i, 520; how possibly cheaper in United States because of protection, i, 525; taxation of, ii, 558, 560.
Technical education and efficiency of industry, i, 103.
Telephone, rates illustrate monopoly value, i, 210; should be monopoly, ii, 400.
Tenancy in United States, ii, 71.
Textile inventions, i, 36.
Thalers in Germany, i, 280.
Three-cornered trade, i, 456.
"Tie-up," ii, 281, 320.
Tin mines of Cornwall, ii, 95.
Tobacco, a medium of exchange, i, 114; how taxed in Great Britain, i, 520; fiscal monopoly of, ii, 559; Trust, *see* American Tobacco Company.
Total Utility, i, 124.
Toynbee, i, 110.
Trade agreements, ii, 314.
Trademark, effect on value and profits, i, 178; relation to dumping, i, 212.
Trade-unions, *see* Contents, ch. 55; out-of-work benefit, ii, 339.
Transferability of corporate shares, consequences of, i, 91.
Transvaal mines, i, 261.
Travelers' expenses, effects on imports and exports, I, 472.
Truck-farm argument for protection, i, 510.
Trust companies, i, 378.
"Trusts," *see* Contents, ch. 63; and horizontal combination, i, 60; how far promoted by protection, I, 521; how far monopolies, ii, 112; origin of name, ii, 420.
Tufts, ii, 254.

Underfed laborers, i, 99.
Undervalued metal, under double standard, i, 267.
Unearned increment, ii, 73; on urban sites, ii, 98; on railways, ii, 383.
Unemployment, not connected with protection, i, 512; strengthens fallacy of "making work," ii, 195, 273; insurance and other provision against, ii, 337.
United States, and geographical division of labor, i, 43, 44; working of protection, i, 540; distribution of income uncertain, ii, 245; income taxes in, ii, 512, 544, 546.
"United States notes," i, 327.
United States Steel Corporation, *see* Steel Corporation.
Urban sites, causes of advantages, ii, 77; relation to prices, ii, 77; incidence of taxes on, ii, 515, 535.

Utility in relation to value, i, 120; diminishing, i, 122; total, i, 124; marginal, i, 125; marginal of money, i, 127; to sellers, why usually of no effect on price, i, 156.

Value in exchange, defined, i, 115; different meanings of, i, 116; of money, i, 236.
Vanderbilt, ii, 41, 390.
Veblen, i, 110.
Vertical combination, i, 60.
Vested interests, as to agricultural land, ii, 74; as to urban sites, ii, 101; as to corporate securities, ii, 114, 403.
Vienna, birthrates in different quarters, ii, 227.
Violence in strikes, ii, 208, 280.

Wages, money rates vary between countries, i, 482; the essential cause of advantage in international trade, i, 502; what determines general rate, *see* Contents, ch. 51; relation to standard of living, ii, 221; effect of taxes on rate of, ii, 547.
Wages argument for protection, i, 513.
Wagner, A., i, 547, ii, 246, 561.
Walker, F., ii, 423.
Walker, F. A., ii, 172.
Walsh, C. M., i, 446.
Walsh banks (of Chicago), i, 417.
Wampum, illustrates influence of convention on money, i, 229.
War debts, a kind of spendthrift borrowing, i, 82; effects on rate of interest, ii, 26, 32; *see also* Public debts.
Water, as a free good and as an economic good, i, 3, 4.
Water competition with railways, ii, 373.
Water power, brings conditions of varying cost, i, 188; how far suited for public management, ii, 403.
Watt, i, 35, ii, 165, 402.
Wealth, *see* Contents, ch. 1.
Webb, ii, 359.
Welfare arrangements, ii, 310.
Wells, H. G., ii, 479.
Welsbach mantles, i, 207.
Westminster, duke of, ii, 99.
Wheat, culture, i, 56; seasonal supply virtually fixed, i, 150; how price may be affected by corners, i, 216; why exported from United States, i, 483; different positions of United States and Russia as exporters of, i, 503; predatory cultivation, ii, 66; yield per acre, ii, 67.
Wicksteed, i, 114.
Wiebe, i, 257.
Willcox, W. F., ii, 224.
Willis, H. P., i, 445.
Withers, H., i, 445.
Wolfe, ii, 228.
Wool, why coarse grades imported into United States, i, 488; varying natural conditions in United States, i, 492; clothing, amount of customs tax on, ii, 558.
Wool-scouring and utilization of grease, i, 55, 220.
Women, wages of, ii. 142.
Workmen's insurance, *see* Contents, ch. 58.

Young, A. A., ii, 232, 241.
Young industries, protection to, i, 526.
Yule, ii, 224.

Printed in the United States of America.